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In accordance with Section 54 of the Central Bank of Kenya Act, it is my honour to present to you, Honourable Cabinet Secretary of the National Treasury, the Annual Report of the Central Bank of Kenya for the Fiscal Year 2013/14. The Annual report contains economic and financial developments and the financial performance of the Central Bank of Kenya for the Fiscal Year ended June 30, 2014.



Prof. Njuguna Ndung'u

Governor

EXECUTIVE SUMMARY

The Global economic growth declined marginally to 3.2 percent in 2013 from 3.5 percent in 2012. The decline was attributed to subdued growth in advanced economies and reflected the recessionary conditions in the Euro area, stagnation in the US and Japan and slowdown in emerging and other developing economies, which more than offset the sustained strong growth performance in Sub-Saharan Africa (SSA).

On the domestic scene the Kenyan economy remained resilient posting real GDP growth of 5.7 percent in 2013. The GDP at 2009 prices was Ksh 3.64 trillion, an improvement over the 4.5 percent growth and output of Ksh 3.44 trillion in 2012. The main sectors accounting for over half of the GDP in 2013 were agriculture, forestry and fishing (22.4 percent), manufacturing (11.1 percent), real estate (8.1 percent), wholesale and retail trade (7.6 percent) and education (6.9 percent). Real output growth from the agriculture, forestry and fishing accelerated to 5.1 percent in 2013 from the 2.9 percent growth recorded in 2012. Production of goods and services is estimated to have expanded by 4.4 percent in the first quarter of 2014 and by 5.8 percent in the second quarter of 2014 compared with 6.4 percent in the first quarter of 2013 and 7.2 percent in the second quarter of 2013.

Monetary policy focused on achieving and maintaining stability in the general level of prices in the economy. In that regard, the monetary policy aimed to confine inflation within the +/- 250 basis points from 5 percent medium term target set by government. Twelve month overall inflation remained within the target bound and rose from 4.91 percent in June 2013 to 7.39 percent in June 2014. The rise was largely on account of food and fuel inflation. Net of the two components, inflation rose minimally from 3.9 percent in June 2013 to 4.5 percent. Besides setting the 5 percent inflation target, the National Treasury also projected real GDP growth of 5.5 percent for the fiscal year 2013/14. Consistent with these targets the Central Bank achieved the monetary programme targets on its Net Domestic Assets (NDA) and Net International Reserves (NIR) during 2013, the final year of the economic programme supported by the IMF's Extended Credit Facility (ECF) 2011-13. The final review of the economic programme supported by the ECF was approved by IMF's Executive Board in December 2013. Under the ECF, Kenya drew SDR 488.52 million (equivalent to USD 748.4 million) in balance of payments support which enhanced the buffer on the NIR. The money supply, (M3), and reserve money, (RM), among other indicators of monetary performance remained within their respective targets. In particular, M3 increased by 18.2 percent compared to the target 15.8 percent largely driven by increases in the Net Foreign Asset (NFA) of the banking system and considerable growth in credit to the private sector.

In order to continue anchoring inflationary expectations and price stability, the Monetary Policy Committee (MPC) maintained the Central Bank Rate (CBR) at the 8.5 percent level set at its May 2013 meeting. Consistent with this stance, the average interbank rate decreased from 7.14 percent in June 2013 to 6.60 percent in June 2014. Similarly, the repo rate decreased

from 7.93 percent to 6.46 percent over the same period. But the 91-day Treasury bill rate increased from 6.21 percent in June 2013 to 9.81 percent in June 2014 on account of higher Government domestic borrowing requirement. Commercial banks' average lending rate remained fairly stable during the year, falling marginally from 16.97 percent in June 2013 to 16.36 percent in June 2014. Similarly, average commercial banks' deposit rate decreased marginally to 6.56 percent in June 2014 from 6.65 percent. As a result, the spread on commercial bank lending rates narrowed marginally by 52 basis points to 9.80 percent during the year to June 2014.

Government budgetary operations in the year to June 2014 resulted in a budget deficit, on commitment basis, of 6.2 percent of GDP, which was well within the revised budget target of 8.2 percent. The deficit was, however, higher than the 5.7 percent recorded in the year to June 2013. Both the Government revenues and expenditures increased less rapidly than had been projected for the year. The shortfall in revenue was in Appropriation in Aid, which more than offset tax receipt in excess of the budget target. The increase in expenditure was all in the development vote and county transfers as recurrent expenditure fell short of the budget target by 7 percent due to the lag between spending at the county level and reporting at the headquarters. Kenya's public and publicly guaranteed debt increased from 44.5 percent of GDP in June 2013 to 49.8 percent in June 2014. The increase was attributed to issuance of Treasury securities to finance the budget deficit, the issuance of Euro Bond of US\$ 2 billion in June 2014 to fund infrastructure projects and the depreciation of the Kenya shilling against the major world currencies.

The Kenya shilling remained stable against major world currencies during the year to June 2014. Against the US\$, the shilling weakened marginally to exchange at an average of Ksh 86.68 in June 2014 compared to Ksh 85.27 in June 2013. The exchange rate stability was supported by increased remittance from the diaspora, disbursements under the ECF supported economic programme and Central Bank of Kenya activities in the foreign exchange market.

Kenya's overall balance of payments position increased to a surplus of US\$ 2,397 million in the year to June 2014 from a surplus of US\$ 627 million in the year to June 2013. The increase reflected growth in the financial account surplus attributed to US\$ 2 billion proceeds from the debut sale of the Eurobond. The deficit in the current account improved marginally (by 0.4 percent) to US\$4,674 million from US\$ 4,693 million during the review period.

The banking system's total foreign exchange holdings increased by 31.8 percent from US\$ 7,889 million in June 2013 to US\$ 10,399 million in June 2014. Official reserves held by the Central Bank of Kenya constituted the bulk of gross reserves and increased by 40.5 percent to US\$ 8,555 million or 5.7 percent of import cover in June 2014, up from 4.4 months of import in June 2013. The accumulation of official reserves during the period consisted of receipts

from the USD 2 billion Eurobond issued in June 2014, IMF disbursements under the ECF programme financing and Central Bank's activities in the foreign exchange market.

The Banking sector recorded improved performance during the year under review with total assets 18 percent higher in June 2014 compared to June 2013. The major components of the balance sheet were loans and advances, government securities and placements which accounted for 58 percent, 21.3 percent and 5.1 percent of total assets, respectively. The stock of gross non-performing loans (NPLs) increased by 31.6 percent from Ksh 77.3 million in June 2013 to Ksh 101.7 million in June 2014. As a result, the ratio of gross NPLs to gross loans increased to 5.7 percent in June 2014 from 5.3 percent in June 2013. All but one of the eleven economic sectors registered increase in NPLs. The increase in NPLs is a carry-over of the high lending rates in 2012 and challenges in the business environment including delayed payments by government to contractors.

The assets of the Central Bank of Kenya increased by 43.5 percent to KSh 854,604 million in June 2014 from KSh 595,530 million in June 2013. The increase was fostered by receipts from diaspora, receipt of the \$2bn Eurobond in June 2014 and movement in exchange rates in the year. The growth in assets reflect in balances due from banking institutions and due from Government of Kenya assets which increased by 51.2 percent (or KSh 230,704 million) and 83.9 percent (or KSh 30,178 million), respectively. The two components respectively accounted for 89.0 percent and 11.6 percent of the increase in total assets. The overdraft to Government however, remained within the prescribed limit while the balances due from banks largely reflect receipt of the Euro bond proceeds (amounting to Ksh 174,993.9 million) in June 2014.

The liabilities on the other hand increased by 45.9 percent to KSh 784,212 million in June 2014 from KSh 537,470 million in June 2013. The increase is attributed to higher liquidity as evidenced by higher deposits from banks and government which accounted for 104.2 percent of the increase in total liabilities of the Central Bank of Kenya. Further disaggregation of the deposits from banks and government component indicate that deposits of other public entities and project accounts increased by Ksh 187,882 million and Government of Kenya accumulated deposits by Ksh 45, 605 million. The two client accounts accounted for 73.1 percent and 17.7 percent of the increase in deposits from banks and Government.

The operations of the Central Bank of Kenya resulted in a net surplus of KSh 13,504 million which was significantly larger compared to KSh 3,573 million posted in the year to June 2013. The surplus comprise largely unrealized foreign exchange gain of KSh 14,759 million, which was KSh 9,136 million or 162 percent higher than in the previous year, with the increase accounting for 92 percent of the surplus build up in the year to June 2014.

Ukuaji wa uchumi ulimwenguni uliimarika kwa kiasi kidogo kutoka asilimia 3.1 katika mwaka wa 2012 hadi asilimia 3.2 katika mwaka wa 2013. Hii ilitokana na kudumaa kwa ukuaji wa chumi za mataifa yaliyoendelea hasa ukanda wa Uropa, Marekani na Japan na kupungua kwa ukuaji wa chumi za mataifa ya Africa Kusini mwa Sahara.

Humu nchini, ukuaji wa Pato la Taifa (GDP) uliimarika hadi asilimia 5.7 katika mwaka wa 2013 kutoka asilimia 4.5 mwaka wa 2012. Kiwango cha Jumla ya Pato la Taifa kilifikia Ksh 3.64 trilioni, ikilinganishwa na Ksh3.44 trilioni katika mwaka wa 2012. Sekta kuu zilizochangia zaidi ukuaji wa Pato la Taifa katika mwaka wa 2013 zilijumuisha kilimo na misitu (22.4 %), viwanda (11.1), biashara ya kijumla na ile ya rejareja (7.6%) na elimu (6.9%). Uzalishaji kamili katika kilimo uliimarika hadi 5.1% katika mwaka wa 2013 kutoka 2.9% katika mwaka wa 2012, matokeo yaliyosababishwa na hali mbaya ya hewa. Kuzalishwa kwa bidhaa na huduma kunakadiriwa kuimarika kwa 4.4% katika robo ya kwanza ya mwaka 2014 na 5.8% katika robo ya pili ikilinganishwa na 6.4% ya robo ya kwanza na 7.2% ya robo ya pili ya mwaka 2013. Kufifia huku kunahusishwa na uzalishaji uliolemazwa katika sekta ya kilimo kutokana na hali mbovu ya hewa pamoja na kudhaifishwa kwa sekta ya utalii kutokana na hofu ya kiusalama.

Sera za kifedha zililenga kuafikia na kudumisha kiwango cha chini cha mfumuko wa bei. Kwa kuzingatia hili, sera ya fedha ilikusudiwa kudhibiti mfumuko kwa kiwango cha wastani cha asilimia 5 kilicholengwa na serikali. Mfumuko wa bei katika miezi kumi na miwili ulisalia katika kiwango lengwa na ukapanda kutoka 4.91% katika mwezi wa Juni, 2013 hadi 7.39% kufikia mwezi Juni mwaka 2014. Kupanda huku kulikuwa hasa kwa mfumuko wa bei ya vyakula na mafuta. Ukiondoa mfumuko katika sehemu hizi mbili, mfumuko uliongeza kidogo kutoka 3.9% katika mwezi Juni 2013 hadi 4.5%. Benki Kuu ya Kenya pia iliafikia malengo yake ya mipango ya kifedha kuhusu Mali zake za Kitaifa (Net Domestic Assets) na Hifadhi za Kimataifa (Net International Reserves) katika mwaka wa 2013, ukiwa ndio mwaka wa mwisho wa mpango huu wa uchumi uliofadhiliwa na Mpango wa Utoaji Mikopo (ECF) wa Shirika la Fedha la Kimataifa (IMF) (2011-13). Tahakiki ya mwisho ya mpango uliofadhiliwa na ECF uliidhinishwa na Bodi Maalum ya IMF mnamo Desemba 2013. Chini ya mpango wa ECF, Kenya ilichukua SDR milioni 488.52 (sawa na dola za Marekani milioni 748.4) kutoka kwenye salio la ufadhili wa malipo ulioimarisha Hifadhi za Kimataifa (NIR). Pesa zilizotolewa, (M3), na hifadhi yake (RM), kati ya viashiria vingine vya matumizi ya pesa vilisalia katika viwango vilivyolengwa. Hususan, M3 iliongezeka kwa asilimia 18.2 ikilinganishwa na kiwango kilicholengwa cha asilimia 15.8 iliyochangiwa hasa na ongezeko la Mali Kamili ya Kigeni (NFA) kwenye mfumo wa benki pamoja na ukuaji wa wastani wa mikopo katika sekta ya kibinafsi.

Ili kugegemeza matarajio ya kinfumko na uimarishaji wa bei, Kamati ya Sera ya Fedha (MPC) ilidumisha kiwango cha Riba ya Benki Kuu (CBR) cha asilimia 8.5, kiwango kilichowekwa wakati wa mkutano wake wa mwezi Mei 2013. Sambamba na msimamo huu, kiwango cha wastani baina ya benki kilipungua kutoka asilimia 7.14 mwezi Juni 2013 hadi asilimia 6.60 katika mwezi Juni 2014. Vilevile, kiwango

cha riba ya mauzo ya rasimali kilipungua kutoka asilimia 7.93 hadi asilimia 6.46 kwa kipindi hicho hicho. Lakini kiwango cha riba cha hisa za dhamana za siku 91 kiliongezeka kutoka asilimia 6.21 mwezi Juni 2013 hadi asilimia 9.81 katika mwezi Juni 2014 kutokana na mahitaji ya kiwango cha juu cha ukopaji wa humu nchini kutoka kwa Serikali. Kiwango cha wastani cha kutoa mkopo katika benki za kibiashara kilisalia imara katika mwaka huo, kikishuka kidogo kutoka asilimia 16.97 mwezi Juni 2013 hadi asilimia 16.36 kufikia Juni 2014. Vilevile kiwango cha uwekaji akiba kwa benki za kibiashara kilipungua kiasi hadi asilimia 6.56 mwezi Juni 2014 kutoka asilimia 6.65. Kutokana na hilo, pengo kati riba ya kutoa mikopo na ile ya uwekaji akiba ilipungua kidogo kufuatia kigezo msingi cha pointi 52 hadi asilimia 9.80 katika kipindi cha mwaka huo kufikia Juni 2014.

Shughuli za kibajeti za Serikali katika mwaka huo kufikia Juni 2014 zilisababisha upungufu katika bajeti, kwa misingi ya utimizaji majukumu, wa asilimia 6.2 ya Jumla ya Pato la Taifa (GDP) ambao ulikuwa katika kiwango lengwa cha asilimia 8.2 ya bajeti iliyofanyiwa marekebisho. Upungufu huo, hata hivyo, ulikuwa wa kiwango cha juu ikilinganishwa na asilimia 5.7 iliyorekodiwa mwaka 2013. Mapato pamoja na matumizi ya serikali yaliongezeka kwa kiasi kidogo kinyume na ilivyokuwa imekadiriwa katika mwaka huo. Upungufu katika pato ulikuwa katika Makadirio ya Misaada, ambao ulikuwa zaidi ya mapato ya ushuru uliopatikana zaidi ya bajeti iliyolengwa. Ongezeko katika matumizi ya mahitaji ya maendeleo na uhamisho wa fedha hadi katika kiwango cha kaunti kwa kuwa matumizi ya kila mara yalipungua yasifikie bajeti iliyolengwa kwa asilimia 7 kutokana na kuchelewa kwa matumizi ya pesa katika kiwango cha kaunti na kuwasiliana na makao makuu. Deni la umma iliongezeka kutoka asilimia 44.5 ya GDP mwezi Juni 2013 hadi asilimia 49.8 mwezi Juni 2014. Kuongezeka huku kulihusishwa na kutolewa kwa Hisa za Dhamana kwa ajili ya kulipia upungufu wa bajeti., kutolewa kwa hisa ya Euro Bond ya dola bilioni 2 mwezi Juni 2014 ili kugharamia maendeleo ya miradi ya miundomsingi na kupungua kwa thamani ya Shilingi ya Kenya dhidi ya sarafu nyingine kuu za ulimwengu.

Sarafu ya Kenya ilisalia kuwa imara dhidi ya sarafu nyingine kuu za ulimwengu katika kipindi cha mwaka hadi kufikia Juni 2014. Dhidi ya dola ya Marekani, shilingi ya Kenya ilishuka kwa kiasi kidogo na ikabadilishwa kwa shilingi 86.68 mwezi Juni 2014 ikilinganishwa na shilingi 85.27 mwezi Juni 2013. Kuimarika kwa kiwango cha ubadilishanaji kulisaidiwa na mpango wa kiuchumi wa ECF pamoja na shughuli za Benki Kuu ya Kenya katika soko la ubadilishanaji wa fedha za kigeni.

Uwezo wa jumla wa kulipa salio uliongezeka hadi kufikia Dola za Marekani milioni 2, 397 katika mwaka huo hadi Juni 2014 kutoka Dola za Marekani milioni 627 wakati kama huo mwaka wa 2013. Kuongezeka huko kuliakisi kukua kwa akaunti ya fedha za ziada, hali iliyohusishwa na Dola za Marekani bilioni 2 zilizotokana na mauzo ya kwanza ya Eurobond. Upungufu katika akaunti ya shughuli za kila mara uliongezeka kwa kiasi (asilimia 0.4) hadi Dola za Marekani milioni 4,674 kutoka Dola za Marekani milioni 4,693 katika mwaka huo unaohakikiwa.

Jumla ya akiba inayotokana na ubadilishanaji wa Kigeni kwenye mfumo wa Benki iliongezeka kwa asilimia 31.8 kutoka Dola za Marekani milioni 7,889 mwezi Juni 2013 hadi Dola milioni 10,399 katika mwezi wa Juni 2014. Hifadhi rasmi zilizokuwamo kwenye Benki Kuu ya Kenya

zilizumuisha hifadhi kubwa ya jumla ya pesa iliyoongezeka kwa asilimia 40.5 hadi Dola milioni 8,555 sawa na asilimia 5.7 ya ununuzi kutoka nchi za kigeni katika mwezi Juni 2014, hili likiwa ongezeko ukilinganisha na ununuzi kutoka nje katika muda wa miezi 4.4 kufikia Juni 2013. Ongezeko la hifadhi rasmi katika kipindi hicho lilijumuisha mapato yaliyotokana na Dola za Marekani bilioni 2 zilizopatikana kutokana na uuzaji wa Eurobond katika mwezi Juni 2014, Utoaji pesa wa IMF chini ya mpango wa ufadhili wa ECF pamoja na shughuli za Benki Kuu kwenye soko la ubadilishanaji wa pesa za kigeni.

Sekta ya benki ilipata matokeo yaliyoimarika katika mwaka huo unaochambuliwa ambapo ilikuwa na jumla ya mali ya asilimia 18 zaidi katika mwezi Juni 2014 ikilinganishwa na Juni 2013. Viungo vikuu vya mizania hiyo vilikuwa mikopo na arubuni na hisa za dhamana za serikali vilivyochangia asilimia 58 na asilimia 21.3 ya jumla ya mali hiyo mtawalia. Hesabu ya jumla ya mikopo isiyolipika (NPLs) iliongezeka kwa asilimia 31.6 kutoka Ksh77.3 milioni mwezi Juni 2013 hadi Ksh 101.7 milioni mnamo Juni 2014. Kwa sababu hiyo, ngawira ya jumla ya NPLs na jumla ya mikopo iliongezeka hadi asilimia 5.7 mnamo Juni 2014 kutoka asilimia 5.3 katika mwezi wa Juni 2013. Sekta zote kumi na moja za uchumi isipokuwa moja tu zilikabiliwa na ongezeko katika NPLs. Ongezeko katika NPLs ni athari ya riba ya juu kwenye mikopo ya 2012 na changamoto za mazingira ya kuendeshea biashara ikiwemo ucheleweshaji wa malipo toka kwa serikali hadi kwa wanakandarasi.

Mali za Benki Kuu ya Kenya ziliongezeka kwa asilimia 43.5 hadi kufikia Shilingi 854, 604 milioni mnamo Juni 2014 kutoka kwa Shilingi 595,530 milioni kufikia mwezi Juni 2013. Ongezeko hilo lilitiwa nguvu na mapato kutoka kwa Wakenya walio katika nchi za kigeni, mapato ya Dola za Marekani bilioni 2 kutokana na Eurobond ya Juni 2014 na mabadiliko katika viwango vya ubadilishanaji fedha katika mwaka huo. Ukuaji wa mali unaoonyeshwa kwenye salio za taasisi za benki na nyingine kutoka kwa mali za Serikali ya Kenya uliongezeka kwa asilimia 51.2 (au Shilingi 230,704 milioni) na asilimia 83.9 (au Shilingi 30,178 milioni), mtawalia. Viungo hivyo viwili mtawalia vilichangia kwa asilimia 89.0 na asilimia 11.6 ndani ya kiwango cha juu kilichowekwa huku salio kutoka kwa benki kwa kiasi kikubwa likionyesha mapato ya Eurobond (yanayofika jumla ya Shilingi 174,993.9 milioni) kufikia mwezi Juni 2014.

Gharama nazo kwa upande mwingine ziliongezeka kwa asilimia 45.9 hadi Shilingi 784,212 milioni kufikia mwezi Juni 2014 kutoka Shilingi 537, 470 milioni mnamo Juni 2013. Ongezeko hilo linahusishwa na kuwepo kwa pesa nyingi taslimu kama ilivyoshuhudiwa kwenye akiba kubwa katika benki na serikali, pesa ambazo zilizumuisha asilimia 104.2 ya ongezeko katika jumla ya gharama za Benki Kuu ya Kenya. Kadhalika ukosefu wa usawazishaji wa akiba za benki na serikali ulionyesha kwamba akiba kutoka kwa mashirika ya umma na akaunti za miradi iliongezeka kwa Shilingi 187,882 milioni nayo akiba ya Serikali ya Kenya ikalimbikizwa kwa Sh 45, 605 milioni. Wateja hao wawili walichangia asilimia 73.1 na 17.7 ya ongezeko la akiba za benki na Serikali.

Shughuli za Benki Kuu ya Kenya zilipelekea kupatikana kwa pesa za ziada kamili ya Shilingi 13, 504 milioni, ambazo kwa kiasi kikubwa zilikuwa zaidi ukilinganisha na Shilingi 3,573 milioni zilizopatikana kufikia mwezi Juni 2013. Kimsingi, nyongeza hiyo ilihusisha mapato ya ubadilishanaji wa fedha za kigeni ya Shilingi 14,759 milioni, ambazo zilikuwa ni sawa na Shilingi 9, 136 milioni au asilimia 162 zaidi ya kiwango cha mwaka uliotangulia, huku ongezeko hili ikilinganishwa na asilimia 92 ya ziada iliyojilimbikiza katika mwaka huo hadi kufikia Juni 2014.

THE CENTRAL BANK OF KENYA ACHIEVEMENTS DURING THE YEAR TO JUNE 2014

The Central Bank of Kenya is established under Section 231 of the Constitution of Kenya (promulgated on August 27, 2010) to be responsible for formulating monetary policy, promoting price stability, issuing currency and performing other functions conferred on it by an Act of Parliament. Its mandates are elucidated in the Central Bank of Kenya Act CAP 491 Section 4 and 4A to include:

❖ Principal objectives

- Formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices'
- Foster the liquidity, solvency and proper functioning of a stable market based financial system

◆ Other Objectives

- Formulate and implement foreign exchange policy
- Hold foreign exchange reserves
- License and supervise authorized dealers
- Formulate and implement such policies as best promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems
- Act as banker and adviser to, and fiscal agent of Government
- Issue currency notes and coin

In the discharge of these objectives, the Central Bank of Kenya is guided by a vision 'to be a world class modern central bank' and a mission 'to formulate and implement monetary policy for price stability and to foster a stable market-based inclusive financial system'. Furthermore in discharging the assigned objectives, the Central Bank of Kenya supports and contributes to the Government's development agenda by ensuring stability in the general level of prices, raising domestic financing requirements for the Government budget, nurturing innovations to enhance financial inclusion and deepening of the financial market and providing an enabling macroeconomic environment for private sector led- growth and development. The performance of the Central Bank of Kenya in all these areas is outlined below.

1. Price Stability

The Central Bank of Kenya conducted prudent monetary policy in the year to June 2014, which delivered stability in the general level of prices. It continued to signal the direction of monetary policy through the Central Bank Rate (CBR), which it maintained steady at 8.50 percent. The stance of monetary policy dampened inflationary expectations which resulted in overall inflation oscillating within the 250 basis points range on either side of the Government's 5 percent medium term target, except in September and October 2013 following the

introduction of VAT across previously exempt products including some food items. The VAT caused an immediate price adjustment which appeared as, but was not, an inflationary spike in view of the one-off nature of the price rise. The Central Bank of Kenya had also to contend with challenges in Government's cash management and fiscal measures which required moderation through Open Market Operations.

The CBR continued to coordinate short term interest rates. However, there were short lived instances of extreme volatility largely triggered by structural rigidities in Government cash management associated with implementation of the devolved system of Government and seasonality of interbank liquidity. The Central bank of Kenya moderated these extremes through open market operations, thereby enabling the interbank rate, which is the operating target for monetary policy, oscillate around the CBR.

Commercial interest rates declined and were fairly consistent with the monetary policy stance. Average lending rates eased gradually from 16.97 percent in June 2013 to 16.36 percent in June 2014 and average deposit rates from 6.65 percent to 6.56 percent. But the average interest rate spread remained high, fluctuating within a narrow range of 9.8 to 10.6 percentage points.

The Kenya Shilling exchange rate remained stable against major world currencies supported by resilient remittances from the diaspora, disbursements under the economic programme 2011-13 supported by the IMF's Extended Credit Facility (ECF), and purchases from the interbank market. It weakened marginally, by 1.65 percent against the USD from an average of KSh 85.27 in the year to June 2013 to an average of KSh 86.68 in the year to June 2014.

The Central Bank of Kenya met the monetary programme targets under the ECF. This programme was successfully reviewed and concluded in December 2013. Under the programme the Central Bank of Kenya accessed a total of SDR488.52 million (equivalent to USD 748.4 million) by way of balance of payments support, which significantly contributed to the buffer¹ maintained above the statutory level of 4 months of imports. The successful conclusion of the ECF supported economic programme is clear demonstration of Government's commitment to sound economic policies and structural reforms. The IMF noted that given the improved macroeconomic conditions Kenya was better placed to withstand shocks and to tap into international financial markets; an accomplishment in June 2014 following the successful issuance of a USD denominated Euro Bond which earned the country USD 2 billion.

2. Financial Sector Stability and Inclusion

¹The level of usable foreign exchange reserves held by the Central Bank of Kenya increased from USD 6,089.0 million (4.05 months of import cover) in June 2013 to USD 8554.5 million (5.52 months of import cover) in June 2014.

The Central Bank of Kenya maintained a sound and efficient banking sector underlined by achievement of financial stability indicators (CAMEL ratings)² and a banking sector that was rated strong. The sector registered improved capital levels and profitability during the year. The Central Bank of Kenya also enhanced reforms to improve efficiency in the banking sector, and notably enhanced uptake of credit information sharing and internalization of credit reference reports by commercial banks in their credit risk appraisal processes. This gives more prominence to credit history rather than collateral which enhance credit uptake and improve loan repayment. The cumulative number of credit reports requested by banks increased by 48.8 percent from 2,905,375 reports in June 2013 to 4,325,200 reports in June 2014. Reflecting the improved credit environment and stable macroeconomic environment, credit uptake by the private sector gained momentum, with annual credit growth accelerating from 12.7 percent in June 2013 to 25.8 percent in June 2014. This credit was largely channeled to productive activities especially in manufacturing, domestic trade, real estate, business services and transport and communications.

The Central Bank of Kenya remained proactive in facilitating financial inclusion through various policy reforms. The outreach for Agency Banking continued to spread with the licensing of 2 more banks to offer banking services through third parties, raising the number of banks to 15 as at June 2014. Furthermore, the enactment of the Microfinance (Amendment) Act 2013 in November led to the rebranding of deposit taking microfinance (DTM) institutions as Microfinance Banks (MFBs). The MFBs recorded considerable growth in: the loan book (46.2 percent), deposits (55.8 percent) and in the number of deposit accounts opened (10.5 percent) during the year.

The Central Bank of Kenya had licensed 5 money remittance providers by the end June 2014, following the operationalisation of the Money Remittance Regulations in April 2013. The respective amendments of the Central Bank of Kenya Act in 2012 purposed to reduce barriers and lower cost of sending and receiving money and increase transparency; foster competition, enhance innovations and increase access to money remittance products and services to the low income group; create an enabling environment; and increase the flow of remittances through formal delivery channels. Reflecting these developments, remittances inflow increased by 13.2 percent from USD 1,199 million in the year to June 2013 to UDS 1,356 million in the year to June 2014.

The Central Bank of Kenya, in collaboration with the other financial sector regulators under the Financial Sector Regulators Forum initiated work to develop a comprehensive database to: support development of surveillance framework for assessing the country's financial system

²Supervisory rating system developed to classify a bank's overall condition in terms of (C)apital adequacy; (A)ssets, (M)anagement Capability, (E)arnings, (L)iquidity or Asset Liability Management, and (S)ensitivity to market risks.

stability; enable policy makers and financial system players better monitor the degree of financial stability at micro and macro levels; anticipate sources and causes of financial stress; and communicate more effectively in a timely manner to address vulnerabilities in the financial system.

3. Facilitating an Effective and Efficient Payments System

The Central Bank of Kenya facilitated efficiency and reliability of the payment and settlement system. It therefore, availed the Kenya Electronic Payments and Settlement System (KEPPS) with minimal interruptions. Access to KEPPS recorded substantial growth in volume and value transacted from 24.9 percent and -1.0 percent in the year to June 2013 to 26.9 percent and 17.5 percent during the year to June 2014, respectively. This performance underscores increased public awareness of KEPPS as a safe and efficient mode of payment for both high value and time critical payments, in addition to effects of other innovations including Value Capping and G-Pay System.

To facilitate safe and efficient cross border payments, the Central Bank of Kenya jointly with other East African Community (EAC) Partner States Central Banks launched the East African Payments System (EAPS) on May 16, 2014 following EAPS go-live on November 15, 2013. The system integrates the real time gross settlement in the EAC member countries to settle intra EAC payments using member country currencies.

In keeping with the Central Bank of Kenya Vision ‘to be a world class modern central bank’, it piloted an internet banking functionality to its clients. The platform will enable clients of the Central Bank of Kenya to transact via the internet for services such funds transfer, on line bidding for Government securities, viewing of account balances and downloading and printing of statement of account. The Central Bank of Kenya will provide and maintain secure communication facilities for this purpose.

4. Service to Government and Commercial Banks

The Central Bank of Kenya, in support of the devolved system of Government, opened accounts for County Governments and addressed the associated operational requirements including training of County officials.

It continued to provide efficient banking services to its clients: commercial banks, Government and other public entities. The Central Bank of Kenya also provided efficient fiscal agency service to Government such as: maintaining a secure, reliable and accurate Government domestic debt securities register and timely and accurate issuance and redemptions of Treasury bills and bonds. It also provided sound advice on macroeconomic and financial policies supportive of economic growth and development.

5. Currency Developments

Towards ensuring adequate supply of currency to facilitate transactions in the economy, the Central Bank of Kenya facilitated 9 percent growth in currency in circulation. It also issued a commemorative gold coin to mark 50 years of Kenya's independence. The coin was issued in three forms: pure gold, gold plated silver and gold plated base metal in an acrylic block. The Central Bank of Kenya sustained public education on counterfeits largely through participation at the national and regional trade fairs and agricultural shows in Nairobi, Mombasa, Kisumu, Eldoret, Nyeri, Nakuru, Meru and Kisii.

6. Support for Regional Integration Initiatives

The Central Bank of Kenya participated in a number of regional integration initiatives and programmes, particularly those related to monetary and financial integration. In this regard, it

- Endorsed the Memorandum of Understanding on currency convertibility and repatriation among the EAC Partners States on May 16, 2014. This MOU seeks to promote convertibility and acceptance of EAC currencies across the region and will therefore enhance trade by reducing transaction costs.
- Participated in the negotiations on the East African Monetary Union (EAMU) Protocol. The Protocol was considered and signed by the Summit of Heads of State in the EAC on November 30, 2013. The process of establishing the EAMU is expected to be finalized by the year 2024.

7. Transformative change at the Central Bank of Kenya

The Central Bank of Kenya embarked on an Organizational Development Review (ODR) process to re-engineer its structure, processes and systems for enhanced effectiveness and efficiency that will facilitate achievement of its strategic goals. Under this process, it has carried out a Business Process Review (BPR) and revised its organizational structure. The ODR is expected to create a more change agile organization with flexibility to adapt in a dynamic environment.

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Governor, Chairman



DR. HARON SIRIMA (OGW)
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DR. KAMAU THUGGE (EBS)
*PS, National Treasury
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Member



MR. JOHN BIRECH
Member

YEAR 2013/14 ANNUAL REPORT: HUMAN RESOURCES DEPARTMENT

Bank Organizational Development Review (ODR)

The Bank has embarked on an Organizational Development Review (ODR) process which is a deliberate planned, organization wide effort to increase effectiveness and efficiency to enable the Bank achieve its strategic goals. Under this process the Bank has carried out a Business Process review (BPR), revised its organizational structures and developed job descriptions that will be critical in job evaluation exercise. The ODR process is expected to culminate to a more change agile organization that will face challenges and be adaptable to changing operating environment.

Learning and Development Initiatives

The Bank has developed a **Leadership and Management Development Program** (LMDP) geared towards building leadership and management capabilities as it embarks on a transformation path to improve organizational effectiveness. The focus of the program is mainly to support talent management, succession planning, embed CBK leadership values & philosophy and build high performing teams that effectively execute the CBK strategic plans.

Work Place and Employee Wellness

In a bid to improve the physical, mental and psychological wellbeing of its employees, the Management of the Bank approved the implementation of the Work place Committee to coordinate Alcohol and Drug Abuse, HIV/Aids, sexual harassment and employee assistance programs in line with National Policies guidelines provided by Government.

Occupational Safety and Health

In an effort to have a safe work environment and dedicated and coordinated approach to drive the occupational safety and health agenda in all the nine (9) workplaces in the Bank has recruited two (2) Safety and Health Officers who will manage occupational safety and health agenda to ensure compliance with the Occupational Safety and Health Act 2007 (OSHA) as well as related regulations.

Gender Mainstreaming

In order to operationalize the Gender Mainstreaming Policy, which is one of the workplace programs, the Bank has developed a Women Empowerment framework under the banner '**Women Leadership Development Program** (WLDP)' that will support the identification and growth of women talents as well as propose solutions to challenges faced by women in the workplace.

Inaugural Annual Wellness Day at the Staff Clinic

The Staff Clinic held the first Annual Wellness Day for Staff in conjunction with the Karen hospital on Saturday November 23rd 2013 with the theme, “Knowledge with action is power”.

Members of the medical scheme who attended were given awareness on cancers, lifestyle illnesses, nutrition, exercises and healthy living.

Year 2014 Inter-Branches/Financial Institutions (KIB) Sports Competitions

The Bank, being the apex financial institution in the banking sector and key member of the Kenya Institute of Bankers (KIB), participated in the 2014 Annual Inter-Banks and Financial Institutions Games. This is an important social event for the Bank as the games bring together members of the banking community to interact in a friendly, cordial and sporting atmosphere.

CBK's Participation in Agricultural Society of Kenya Shows

The Bank continues to spread awareness on its services and products using the Agricultural Society of Kenya (ASK) shows. In this activity, the Bank teams up with other Financial Sector Regulators in joint platform and now participates in the ASK shows held in Nairobi, Mombasa, Kisumu, Kisii, Meru, Nyeri, Nakuru and Eldoret.

1. WORLD ECONOMY

Growth of the world economy is expected to rise marginally from 3.2 percent in 2013 to 3.4 percent in 2014 and 4.0 percent in 2015. The improvement is driven largely by moderation of fiscal consolidation and accommodative monetary policies in most advanced economies.

Across the advanced economies, growth is expected to rise to 1.8 percent in 2014 (from 1.3 percent in 2013) and 2.4 percent in 2015. The United States economy is projected to stagnate at 1.7 percent growth in 2014 compared with 1.9 percent in 2013 before picking up to 3.0 percent in 2015. Growth in the Euro area is expected to strengthen from recession in 2013 to 1.1 percent in 2014 and 1.5 percent in 2015. In Japan growth is projected to stagnate at 1.6 percent in 2014 (compared with 1.5 percent in 2013) and to further weaken to 1.1 percent in 2015 on account of planned unwinding of Fiscal stimulus.

Growth in the emerging and developing economies is projected to decrease to 4.6 percent in 2014 from 4.7 percent experienced in 2013 and accelerate to a modest 5.2 percent in 2015. In Sub-Saharan Africa (SSA), growth prospects remain strong following a 5.4 percent forecast in 2014 (unchanged from 2013 performance) and pick to 5.8 percent in 2015. Growth is more robust in the Middle East and North Africa compared with South Africa in 2014 (Table 1.1).

TABLE 1.1: ACTUAL, AND PROJECTED OUTPUT GROWTH OF SELECTED COUNTRIES/REGIONS 2012 - 2015

Country/Region	2012	2013	2014	2015
World	3.5	3.2	3.4	4.0
Advanced economies	1.4	1.3	1.8	2.4
USA	2.8	1.9	1.7	3.0
Euro area	- 0.7	- 0.4	1.1	1.5
UK	0.3	1.7	3.2	2.7
Japan	1.4	1.5	1.6	1.1
Emerging market and developing economies	5.1	4.7	4.6	5.2
Emerging and Developing Asia	6.7	6.6	6.4	6.7
China	7.7	7.7	7.4	7.1
India	4.7	5.0	5.4	6.4
Latin America and the Caribbean	2.9	2.6	2.0	2.6
Brazil	1.0	2.5	1.3	2.0
Sub-Saharan Africa	5.1	5.4	5.4	5.8
*Middle East and North Africa	4.1	2.2	3.2	4.5
South Africa	2.5	1.9	1.7	2.7

* As reported in the April 2014 World Economic Outlook
Source: IMF, World Economic Outlook July 2014 update

The downside risks to the growth outlook of the World Economy include the geopolitics of the Middle East and Ukraine which could generate high spikes in oil prices, stagnation in advanced economies and worsening of financial conditions and reversal of capital flows in the emerging economies. In Sub-Saharan Africa, the outbreak of the Ebola disease in parts of West Africa and terrorist threats could affect travel and tourism in the region in 2014.

Capital Flows

Net capital flows to developing countries increased marginally by 1.1 percent in 2012 to US\$ 1,121.6 billion from US\$ 1,109.3 billion in 2011. The regions recording the highest increase were Latin America and the Caribbean (16.6 percent), Middle East and North Africa (220.6 percent), South Asia (13.5 percent) and Sub-Saharan Africa (17 percent). Meanwhile, net capital flows to East Asia and the Pacific declined by 11.1 percent while flows to Europe and Central Asia declined by 10.6 percent (Table 1.2).

**TABLE 1.2: NET CAPITAL FLOWS TO DEVELOPING COUNTRIES
BY CATEGORY 2007 - 2012 (US\$ Billion)**

USD Billion	2007	2008	2009	2010	2011	2012
By region:						
East Asia and the Pacific	298.4	208.2	259.0	529.6	546.4	485.8
Europe and Central Asia	263.6	249.9	104.3	105.9	126.1	112.7
Latin America and the Caribbean	213.1	163.1	160.4	303.4	267.7	312.2
Middle East and North Africa	30.1	23.8	30.9	31.4	10.2	32.7
South Asia	115.8	64.6	89.9	107.0	84.7	96.1
Sub-Saharan Africa	58.1	46.6	56.5	59.5	62.9	73.6
Total Net private and official inflows	1049.8	831.2	698.0	1161.1	1109.3	1121.6

Source: World Bank, *International Debt Statistics*, 2014

Net equity flows which comprise foreign Direct Investment (FDI) and portfolio equity increased marginally by 8 percent to US\$ 709.7 billion in 2012 and accounted for 63.3 percent of total capital flows. The increase was mainly on portfolio equity. Net Foreign Direct Investment (FDI) flows to developing countries decreased by 6.5 percent in 2012 to US\$ 612.2 billion from US\$ 654.7 billion in 2011. Debt related flows which accounted for 36.7 percent of the total capital flows recorded an 8.9 percent decrease from US\$ 451.9 billion in 2011 to US \$ 411.8 billion in 2012. The decrease in debt flows reflected 8.6 percent decrease in net private creditors' flows and 12.8 percent decrease in flows from official creditors (Table 1.3).

**TABLE 1.3: NET CAPITAL FLOWS TO DEVELOPING COUNTRIES
BY CATEGORY 2007 - 2012 (US\$ Billion)**

	2007	2008	2009	2010	2011	2012
Net Capital Flows	1049.8	831.2	698.0	1161.1	1109.3	1121.6
of which						
1. Net equity inflows	667.1	582.8	491.3	634.9	657.4	709.7
Net FDI inflows	558.6	623.4	380.3	511.6	654.7	612.2
Net portfolio equity inflows	109	-40.6	110.9	123.4	2.7	97.6
2. Net debt flows	382.1	248.4	206.7	481.2	451.9	411.8
Official creditors	3.2	42.7	93.8	80.1	32	27.9
Private creditors	378.9	205.6	112.9	401	419.9	383.9

Source: World Bank, International Debt Statistics, 2014

Remittances to Developing Countries

The growth in flows from remittances in 2013 was generally robust in all regions. Remittances to developing countries increased by 3.1 percent to US\$ 404 billion in 2013 from US\$392 billion in 2012. East Asia and the Pacific and South Asia accounted for the largest share of total flows at 27.7 percent and 27.5 percent, respectively. Europe and Central Asia accounted for 10.6 percent while Latin America and the Caribbean accounted for 15.1 percent. Middle East and North Africa took 11.4 percent share and Sub-Saharan Africa 7.9 percent of total flows (Table 1.4).

TABLE 1.4: WORKERS REMITTANCES TO DEVELOPING COUNTRIES 2008 - 2011(US\$ billion)

	2010	2011	2012	2013e	2014f
Developing Countries	333	373	392	404	436
East Asia and Pacific	95	107	107	112	123
Europe and Central Asia	32	38	39	43	45
Latin America and Caribbean	56	59	60	61	66
Middle East and North Africa	40	42	47	46	49
South Asia	82	96	108	111	118
Sub-Saharan Africa	29	31	31	32	35

*e- Estimate

*f- Forecast

Source: World Bank, Migration and Development Brief April 2014

DOMESTIC ECONOMY - OVERVIEW

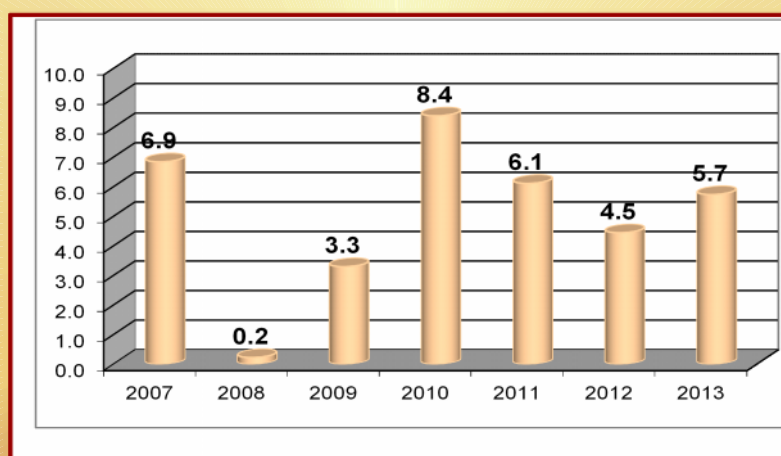
The Kenyan economy was resilient in 2013, posting a growth rate of 5.7 percent compared with growth of 4.5 percent in 2012 and 6.1 percent in 2011 (Chart 2A). In 2013, total output of goods and services amounted to Ksh 3.64 trillion compared with Ksh 3.44 trillion in 2012. The sectors contributing most to growth in 2013 included Agriculture, Forestry and Fishing (22.4 percent), Manufacturing (11.1 percent), Real Estate (8.1 percent), Wholesale and Retail Trade (7.6 percent), Education (6.9 percent), Transport and Storage (6.6 percent) and Financial and Insurance Activities (5.9 percent). In the first and second quarters of 2014, the production of goods and services is estimated to have expanded by 4.4 percent and 5.8 percent, respectively, compared with 6.4 percent in the first quarter of 2013 and 7.2 percent in the second quarter of 2013.

Real GDP in 2013 grew by 5.7 percent and amounted to Ksh 3.64 trillion compared with 4.5 percent growth in 2012 (Table 2.1 and Chart 2A).

TABLE 2.1: REAL GROSS DOMESTIC PRODUCT AND RELATED AGGREGATES

	Share in 2013 Nominal GDP (%)	Share in 2013 Real GDP (%)	2006	2007	2008	2009	2010	2011	2012	2013
MAIN SECTORS										
Agriculture, forestry and fishing	26.27	22.40	685,710	720,612	684,702	668,969	736,195	753,598	775,799	815,087
Mining and quarrying	0.81	0.85	13,849	16,289	16,296	18,134	23,884	28,428	33,830	30,795
Manufacturing	10.43	11.12	327,918	342,267	346,177	342,532	357,958	383,891	381,942	404,502
Electricity supply	1.06	1.54	34,035	39,792	36,947	39,162	40,545	45,949	52,187	56,045
Water supply; sewerage, waste management	0.87	0.83	22,769	22,558	22,885	24,869	27,493	28,489	29,390	30,270
Construction	4.46	4.48	89,513	97,119	95,474	112,219	133,647	139,033	154,621	163,075
Wholesale and retail trade; repairs	7.85	7.63	172,625	186,328	189,326	200,032	219,221	237,516	254,231	277,699
Transport and storage	7.38	6.62	173,502	185,955	191,536	205,774	215,970	231,340	237,734	240,764
Hotels and restaurants	1.23	1.44	50,040	57,300	39,471	51,510	51,238	53,333	54,972	52,441
Information and communication	1.44	3.36	51,720	61,952	67,574	73,691	86,492	105,483	107,773	122,310
Financial and insurance activities	6.58	5.89	133,353	139,918	146,815	150,411	176,968	185,206	196,265	214,497
Real estate	7.89	8.10	214,219	224,439	235,102	246,546	258,953	272,055	283,061	294,747
Professional, scientific and technical activities	0.99	1.06	26,509	29,836	31,343	33,085	34,092	34,628	36,440	38,553
Administrative and support service activities	1.20	1.33	40,829	43,849	39,645	44,151	45,422	46,546	47,619	48,303
Public administration and defence	4.80	3.88	109,013	111,635	119,363	127,807	129,710	132,986	140,851	141,198
Education	5.43	6.92	145,223	154,720	168,955	177,993	196,171	210,958	235,476	251,650
Human health and social work activities	1.58	1.72	50,447	53,561	56,076	58,686	62,345	60,723	58,761	62,752
Arts, entertainment and recreation	0.14	0.14	3,887	3,951	3,945	4,326	4,853	5,026	4,892	5,076
Other service activities	0.62	0.67	20,144	20,703	21,004	20,885	21,618	21,853	22,732	24,294
Activities of households as employers	0.54	0.51	16,623	16,873	17,126	17,383	17,643	17,908	18,177	18,449
FISIM	(2.57)	(2.40)	(49,597)	(51,383)	(53,675)	(59,373)	(68,827)	(75,076)	(82,648)	(87,358)
All economic activities	89.00	88.08	2,332,335	2,478,274	2,476,088	2,558,791	2,771,591	2,919,872	3,044,104	3,205,148
Taxes on products	11.00	11.92	255,944	287,322	295,931	304,896	332,810	374,582	397,028	433,613
GDP at market prices	100.00	100.00	2,588,279	2,765,595	2,772,019	2,863,688	3,104,401	3,294,454	3,441,132	3,638,761
Overall GDP Deflator (2009=100)			72	78	90	100	102	113	124	131
Growth Rates (Percent)										
	Share in 2013 Nominal GDP (%)	Share in 2013 Real GDP (%)	2006	2007	2008	2009	2010	2011	2012	2013
Agriculture, forestry and fishing	26.27	22.40	...	5.1	-5.0	-2.3	10.0	2.4	2.9	5.1
Mining and quarrying	0.81	0.85	...	17.6	0.0	11.3	31.7	19.0	19.0	(9.0)
Manufacturing	10.43	11.12	...	4.4	1.1	-1.1	4.5	7.2	(0.5)	5.9
Electricity supply	1.06	1.54	...	16.9	-7.1	6.0	3.5	13.3	13.6	7.4
Water supply; sewerage, waste management	0.87	0.83	...	-0.9	1.4	8.7	10.6	3.6	3.2	3.0
Construction	4.46	4.48	...	8.5	-1.7	17.5	19.1	4.0	11.2	5.5
Wholesale and retail trade; repairs	7.85	7.63	...	7.9	1.6	5.7	9.6	8.3	7.0	9.2
Transport and storage	7.38	6.62	...	7.2	3.0	7.4	5.0	7.1	2.8	1.3
Hotels and restaurants	1.23	1.44	...	14.5	-31.1	30.5	-0.5	4.1	3.1	(4.6)
Information and communication	1.44	3.36	...	19.8	9.1	9.1	17.4	22.0	2.2	13.5
Financial and insurance activities	6.58	5.89	...	4.9	4.9	2.4	17.7	4.7	6.0	9.3
Real estate	7.89	8.10	...	4.8	4.8	4.9	5.0	5.1	4.0	4.1
Professional, scientific and technical activities	0.99	1.06	...	12.6	5.1	5.6	3.0	1.6	5.2	5.8
Administrative and support service activities	1.20	1.33	...	7.4	-9.6	11.4	2.9	2.5	2.3	1.4
Public administration and defence	4.80	3.88	...	2.4	6.9	7.1	1.5	2.5	5.9	0.2
Education	5.43	6.92	...	6.5	9.2	5.3	10.2	7.5	11.6	6.9
Human health and social work activities	1.58	1.72	...	6.2	4.7	4.7	6.2	-2.6	(3.2)	6.8
Arts, entertainment and recreation	0.14	0.14	...	1.6	-0.2	9.7	12.2	3.6	(2.7)	3.8
Other service activities	0.62	0.67	...	2.8	1.5	-0.6	3.5	1.1	4.0	6.9
Activities of households as employers	0.54	0.51	...	1.5	1.5	1.5	1.5	1.5	1.5	1.5
FISIM	-2.57	-2.40	...	3.6	4.5	10.6	15.9	9.1	10.1	5.7
All economic activities	89.00	88.08	...	6.3	-0.1	3.3	8.3	5.4	4.3	5.3
Taxes on products	11.00	11.92	...	12.3	3.0	3.0	9.2	12.6	6.0	9.2
GDP at market prices	100.00	100.00	...	6.9	0.2	3.3	8.4	6.1	4.5	5.7

Sources: Economic Survey 2013

CHART 2A: REAL GDP GROWTH RATES, 2007 - 2013 (%)

*Provisional

Sources: Economic Survey

The sectors contributing most to growth in 2013 included Agriculture, Forestry and Fishing (22.4 percent), Manufacturing (11.1 percent), Real Estate (8.1 percent), Wholesale and Retail Trade (7.6 percent), Education (6.9 percent), Transport and Storage (6.6 percent) and Financial and Insurance Activities (5.9 percent). In the first and second quarters of 2014, the production of goods and services is estimated to have expanded by 4.4 percent and 5.8 percent, respectively, compared with 6.4 percent in the first quarter of 2013 and 7.2 percent in the second quarter of 2013.

AGRICULTURE

Recent indicators, however, point to a slowdown in the July-June 2014 period. Real output in agriculture, forestry and fishing increased by 5.1 percent in 2013, an improvement from 2.9 percent in 2012. The sector's contribution to real GDP marginally declined from 22.5 percent to 22.4 percent.

Production of tea declined by 1.1 percent in the July-June 2013/14 period, sales of coffee declined by 7.0 percent while the amount of raw milk delivered for processing declined by 2.6 percent over the same period. Meanwhile, growth in exports of fresh horticultural products decelerated to 8.5 percent in July-June 2013/14 period largely reflecting subdued demand from Europe. Sugar cane production, however increased by 27.4 percent in July-June 2013/14 compared 3.9 percent increase in July-June 2012/13 period (Table 2.2).

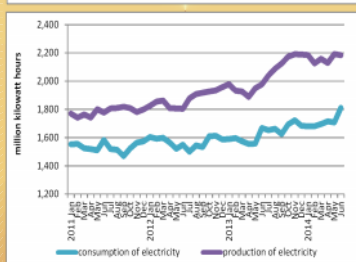
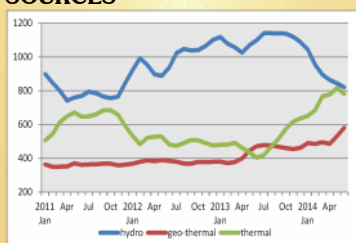
TABLE 2.2: OUTPUT GROWTH IN KEY CROPS

	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12	Jul/Jun 2012/13	Jul/Jun 2013/14
Tea							
Production (Tonnes)	328,213	327,712	377,927	364,456	357,625	437,009	432,018
Annual Growth, %	-12.5%	-0.2%	15.3%	-3.6%	-1.9%	22.2%	-1.1%
Coffee							
Sales (Tonnes)	39,842	53,701	34,651	30,574	44,035	42,966	39,940
Annual Growth, %	-21.7%	34.8%	-35.5%	-11.8%	44.0%	-2.4%	-7.0%
Horticulture							
Exports (Tonnes)	283,780	244,717	248,664	258,388	234,764	285,592	309,951
Annual Growth, %	29.7%	-13.8%	1.6%	3.9%	-9.1%	21.7%	8.5%
Sugar Cane							
Deliveries (Tonnes)	3,796,562	5,392,907	5,429,438	6,039,241	5,376,060	5,585,200	7,117,160
Annual Growth, %	-23.4%	42.0%	0.7%	11.2%	-11.0%	3.9%	27.4%
Milk							
Intake (Million Litres)	397	391	495	504	506	550	536
Annual Growth, %	-1.2%	-1.6%	26.6%	1.8%	0.5%	8.7%	-2.6%

Source: Kenya National Bureau of Statistics

MANUFACTURING

The manufacturing sector accounted for 11.1 percent of the overall GDP in 2013 (Table 2.3). Total output from the sector grew by 5.9 percent in 2013 compared with a contraction of 0.5 percent in 2012. Available data indicate a faster growth in the selected activities in the sector during July -June 2013/14 compared with the same period of 2012/13. For instance, growth in production of cement increased by 15.9 percent, the amount of sugar processed by 37.5 percent, production of soft drinks by 20.4 percent and the number of motor vehicles assembled locally by 28.4 percent.

CHART 2B: PERCENTAGE SHARE OF ELECTRICITY SOURCES

Source: Kenya Power & Lighting Co.

TABLE 2.3: PRODUCTION OF SELECTED MANUFACTURED GOODS

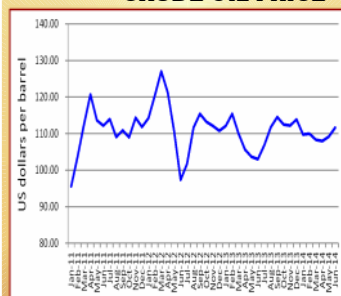
	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12	Jul/Jun 2012/13	Jul/Jun 2013/14
Processed Sugar							
Production (Tonnes)	530,129	536,893	507,217	572,800	459,276	475,749	654,234
Annual Growth, %	11.6%	1.3%	-5.5%	12.9%	-19.8%	3.6%	37.5%
Soft Drinks							
Production ('000 Litres)	319,850	368,957	363,501	368,134	366,370	372,680	448,534
Annual Growth, %	11.8%	15.4%	-1.5%	1.3%	-0.5%	1.7%	20.4%
Galvanised Sheets*							
Production (Tonnes)	191,939	183,769	196,193	237,370	254,680	282,166	298,857
Annual Growth, %	7.1%	-4.3%	6.8%	21.0%	7.3%	10.8%	5.9%
Cement							
Production (Tonnes)	2,633,494	3,123,473	3,485,639	4,120,493	4,582,710	4,719,014	5,469,954
Annual Growth, %	11.1%	18.6%	11.6%	18.2%	11.2%	3.0%	15.9%
Assembled Vehicles							
Production (Units)	6,535	5,249	5,286	5,600	6,445	6,324	8,118
Annual Growth, %	9.9%	-19.7%	0.7%	5.9%	15.1%	-1.9%	28.4%

Source: Kenya National Bureau of Statistics

ENERGY SECTOR DEVELOPMENTS

Production of electricity accelerated to 11.3 percent in July-June 2013/14 (Table 2.4). The total amount of electricity generated increased from 7,779 million kilowatt hours in July-June 2012/13 to 8,656 million kilowatt hours in July-June 2013/14. Much of this growth was attributed to thermal and geo-thermal generation. Production of thermal electricity increased by 43.6 percent to 2,703 million kilowatt hours in July-June 2013/14 while production of geo-thermal electricity increased by 25.5 percent to 2,008 million kilowatt hours in July-June 2013/14 (Chart 2B). Production of hydro-electricity, however, reduced to 3,945 in July-June 2013/14. Meanwhile, demand for electricity increased during the review period, with consumption of electricity rising to 6,818 million kilowatt hours (or 7.1 percent) in July-June 2013/14.

**CHART 2C: SAUDI ARABIAN
CRUDE OIL PRICE**



Source: Ministry of Energy

TABLE 2.4: PERFORMANCE OF ENERGY SUB-SECTORS

	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12	Jul/Jun 2012/13	Jul/Jun 2013/14
Electricity Generation Output (Million KWH)	6,067	5,544	5,557	7,006	7,287	7,779	8,656
Annual Growth, %	-0.5%	-8.6%	0.2%	26.1%	4.0%	6.8%	11.3%
Of which:							
Hydro-power Generation (Million KWH)	3,488	2,849	2,155	3,427	3,505	4,298	3,945
Annual Growth, %	5.7%	-18.3%	-24.4%	59.0%	2.3%	22.6%	-8.2%
Geo-Thermal Generation (Million KWH)	1,021	1,179	1,524	1,454	1,504	1,599	2,008
Annual Growth, %	0.6%	15.5%	29.3%	-4.6%	3.5%	6.3%	25.5%
Thermal (Million KWH)	1,558	1,516	1,877	2,125	2,277	1,882	2,703
Annual Growth, %	-12.6%	-2.7%	23.8%	13.2%	7.2%	-17.4%	43.6%
Consumption of Electricity (Million KWH)	5,243	5,328	5,602	6,056	6,192	6,363	6,818
Annual Growth, %	5.6%	1.6%	5.1%	8.1%	2.3%	2.8%	7.1%

Sources: Kenya National Bureau of Statistics

International crude oil prices remained high through most of July-June 2013/14 period (Chart 2C). The price of murban crude oil imported to Kenya increased from US\$ 103.0 per barrel in June 2013 to US\$ 111.65 per barrel in June 2014.

BUILDING AND CONSTRUCTION

Consumption of cement, a key indicator of building and construction, showed improved performance in July-June 2013/14 compared with July-June 2012/13. Consumption of cement increased by 16.9 percent from 4,023,013 metric tonnes in July-June 2012/13 to 4,702,191 metric tonnes in July-June 2013/14. The value of building plans approved by Nairobi City Council also improved by 15.4 percent from Ksh 204,910 million in the year to May 2013 to Ksh 236,578 million in July-June 2013/14.

TRANSPORT AND COMMUNICATION

Transport

Performance in the transport sector declined in the July-June 2013/14 period compared with the performance recorded in July-June 2012/13. The number of passengers passing through the Jomo Kenyatta International Airport, Nairobi declined by 10.1 percent while the volume of fuel put through the Kenya Pipeline decelerated to 7.0 percent growth, from 11.5 percent in 2013/14 (Table 2.5).

TABLE 2.5: PERFORMANCE OF TRANSPORT SUB-SECTORS

Activity	Jul/Jun 2007/08	Jul/Jun 2008/09	Jul/Jun 2009/10	Jul/Jun 2010/11	Jul/Jun 2011/12	Jul/Jun 2012/13	Jul/Jun 2013/14
Passengers through JKIA*							
Total passenger flows	2,866,801	2,866,915	2,681,851	3,585,897	4,416,420	4,330,048	3,893,253
Number of incoming passengers	1,415,364	1,424,993	1,335,443	1,811,770	2,219,345	2,156,283	1,942,602
Growth %	-6.2%	0.7%	-6.3%	35.7%	22.5%	-2.8%	-9.9%
Number of outgoing passengers	1,451,437	1,441,922	1,346,408	1,774,127	2,197,075	2,173,765	1,950,651
Growth %	-3.3%	-0.7%	-6.6%	31.8%	23.8%	-1.1%	-10.3%
Throughput by Kenya Pipeline							
Output ('000 litres Equivalent)	3,873,855	4,058,727	4,317,439	4,149,757	4,536,099	5,055,838	5,408,595
Output Growth %	-2.3%	4.8%	6.3%	-3.9%	9.3%	11.5%	7.0%

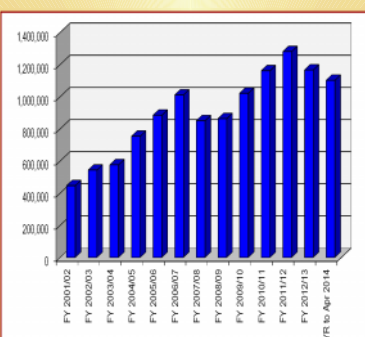
*Jul/Jun 2013/14 reflects data for the year to May 2014

Sources: Kenya Airports Authority, Kenya Pipeline and Kenya National Bureau of Statistics

TOURISM

The number of tourists arriving in Kenya in July-June 2013/14 declined by 10.9 percent compared with 9.3 percent contraction in the previous year. The reduction in tourist arrivals is in part attributed to concerns over security. The reduction in the current review period is reflected both in arrivals through the Jomo Kenyatta International Airport, Nairobi (JKIA) the Moi International Airport, Mombasa (MIAM) (Table 2.6 and Chart 2D).

CHART 2D: TOURIST ARRIVALS



Source: Kenya Tourist Board

TABLE 2.6: TOURIST ARRIVALS BY POINT OF ENTRY

	FY 2007/08	FY 2008/09	FY 2009/10	FY 2010/11	FY 2011/12	FY 2012/13	FY 2013/14
Cruise ships	3,531	15,518	287	586	270	-	-
Growth %	-39.6%	339.5%	-91.9%	104.2%	-53.9%		
JKIA	667,640	691,244	819,843	913,789	1,070,776	978,909	862,845
Growth %	-8.7%	3.5%	22.8%	11.5%	17.2%	-8.6%	-11.9%
MIAM	179,285	156,991	201,611	247,032	209,842	182,651	172,370
Growth %	-34.5%	-12.4%	12.5%	22.5%	-15.1%	-13.0%	-5.6%
Total	850,456	863,753	1,021,741	1,161,407	1,280,888	1,161,560	1,035,215
Growth %	-19.4%	1.6%	20.1%	13.7%	10.3%	-9.3%	-10.9%

FY - Fiscal year

Source: Kenya Tourist Board

USE OF AVAILABLE RESOURCES

Total resources available to the economy measured as gross national disposable income decreased albeit minimally from 105.3 percent of GDP in 2012 to 105.1 percent of GDP in 2013 (Table 2.7). The resources were largely spent on consumption, which comprised 94.1 percent of GDP in 2013 compared with 92.6 percent of GDP in 2012. The increase in the share of total consumption in GDP was attributed to private consumption, whose share rose from 78.6 percent of GDP in 2012 to 80.0 percent of GDP in 2013. The share of Government consumption stabilized at 14.0 percent of GDP in 2013. The share of gross domestic investment in GDP, however, declined from 21.6 percent in 2012 to 19.9 percent in 2013. Gross national savings as a percent of GDP also declined from 12.7 percent in 2012 to 5.4 percent in 2013. The Savings-Investment gap therefore stabilized at 8.9 percent of GDP in 2013.

In the external sector, the share of exports of goods and services in GDP declined from 19.8 percent in 2012 to 17.7 percent in 2013, while the share of imports of goods and services declined from 35.5 percent to 33.2 percent in the period under review. The current account deficit as a percent of GDP therefore stabilized at 8.9 percent of GDP in 2013.

TABLE 2.7: USE OF RESOURCES (KSH MILLION)

	2007	2008	2009	2010	2011	2012	2013
Gross national disposable income	2,141,643	2,480,868	2,860,234	3,157,638	3,726,671	4,242,316	4,730,978
Net current transfers (TR(F))	141,931	161,264	177,853	184,393	275,496	237,498	270,132
Gross national income	1,999,712	2,319,604	2,682,381	2,973,245	3,451,175	4,004,818	4,460,846
Net factor income payments (Y(f))	-151,637	-163,454	-181,307	-196,090	-274,877	-249,954	-296,686
Gross domestic product (at market prices)	2,151,349	2,483,058	2,863,688	3,169,335	3,726,052	4,254,772	4,757,532
Total Consumption (C)	1,925,119	2,259,621	2,619,294	2,894,359	3,458,413	3,940,473	4,475,430
Government consumption - C(g)	314,734	389,194	435,695	449,064	522,062	596,065	668,246
Private consumption - C(p)	1,610,385	1,870,427	2,183,599	2,445,295	2,936,351	3,344,408	3,807,184
Gross domestic investment (I)	440,101	486,995	553,626	660,518	808,627	917,906	947,789
Gross fixed capital formation	429,511	468,427	529,927	645,647	759,746	903,740	971,203
Increase/Decrease in stocks	10,590	18,568	23,699	14,871	48,881	14,166	-23,414
Exports of goods and nfs (X)	471,554	563,010	573,672	654,689	805,766	844,425	843,490
Imports of goods and nfs (M)	-687,911	-866,700	-882,904	-1,063,942	-1,446,502	-1,508,672	-1,577,905
Discrepancy	2,486	40,131	0	23,711	99,748	60,639	68,729
GDP deflator (2001=100)	77.8	89.6	100.0	102.1	113.1	123.6	130.7
Real GDP	2,765,595	2,772,019	2,863,688	3,104,401	3,294,454	3,441,132	3,638,761
Real GDP growth (annual in %)	6.9%	0.2%	3.3%	8.4%	6.1%	4.5%	5.7%
Gross National savings	216,524	221,247	240,940	263,279	268,258	301,843	255,548
Gross Domestic Savings	74,593	59,983	63,087	78,886	-7,238	64,345	-14,584
Total National Balance(S-I)	-223,577	-265,748	-312,686	-397,239	-540,369	-616,063	-692,241
CAB (X-M+Y(f)+TR(f))	-226,063	-305,880	-312,686	-420,950	-640,117	-676,703	-760,969
Discrepancy	2,486	40,132	0	23,711	99,748	60,640	68,728
CAB + DISCREPANCY	-223,577	-265,748	-312,686	-397,239	-540,369	-616,063	-692,241
Kenya - National Accounts in shares of GDP							
Gross national disposable income	99.55%	99.91%	99.88%	99.63%	100.02%	99.71%	99.44%
Net current transfers (TR(f))	6.60%	6.49%	6.21%	5.82%	7.39%	5.58%	5.68%
Gross national income	92.95%	93.42%	93.67%	93.81%	92.62%	94.13%	93.76%
Net factor income payments (Y(f))	-7.05%	-6.58%	-6.33%	-6.19%	-7.38%	-5.87%	-6.24%
Gross domestic product (GDP)							
Gross Domestic Product (expend)							
Total Consumption (C)	89.48%	91.00%	91.47%	91.32%	92.82%	92.61%	94.07%
Government consumption - C(g)	14.63%	15.67%	15.21%	14.17%	14.01%	14.01%	14.05%
Private consumption - C(p)	74.85%	75.33%	76.25%	77.15%	78.81%	78.60%	80.02%
Gross domestic investment (I)	20.46%	19.61%	19.33%	20.84%	21.70%	21.57%	19.92%
Gross fixed capital formation	19.96%	18.86%	18.51%	20.37%	20.39%	21.24%	20.41%
Increase/Decrease in stocks	0.49%	0.75%	0.83%	0.47%	1.31%	0.33%	-0.49%
Exports of goods and services (X)	21.92%	22.67%	20.03%	20.66%	21.63%	19.85%	17.73%
Imports of Goods and services (M)	-31.98%	-34.90%	-30.83%	-33.57%	-38.82%	-35.46%	-33.17%
Gross National savings	10.06%	8.91%	8.41%	8.31%	7.20%	7.09%	5.37%
Gross Domestic Savings	3.47%	2.42%	2.20%	2.49%	-0.19%	1.51%	-0.31%
Total National Balance(S-I)	-10.4%	-10.7%	-10.9%	-12.5%	-14.5%	-14.5%	-14.6%
Trade Balance (TB=X-M)	-10.1%	-12.2%	-10.8%	-12.9%	-17.2%	-15.6%	-15.4%
CAB (X-M+Y(f)+TR(f))	-10.5%	-12.3%	-10.9%	-13.3%	-17.2%	-15.9%	-16.0%
CAB + DISCREPANCY	-10.4%	-10.7%	-10.9%	-12.5%	-14.5%	-14.5%	-14.6%

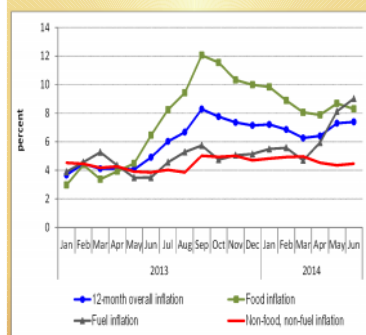
Source: Economic Survey, various issues, Kenya National Bureau of Statistics

MONETARY POLICY MANAGEMENT

3. INFLATION

The Kenya consumer price index (CPI) rose by 7.4 percent from 139.6 in June 2013 to 149.9 in June 2014 (Table 3.1). The annual average rate of inflation also rose by 7.1 percent by June 2014 compared with 4.6 percent in June 2013. The rise in overall 12-month inflation in the year to June 2014 was largely reflected in fuel inflation as shown in Chart 3A. Both measures of inflation remained within the 250 basis points' inflation corridor in relation to the 5 percent medium term target.

CHART 3A: TRENDS IN OVERALL INFLATION, FOOD INFLATION, FUEL INFLATION, & NON-FOOD, NON-FUEL INFLATION



Source: Kenya National Bureau of Statistics & Central Bank of Kenya

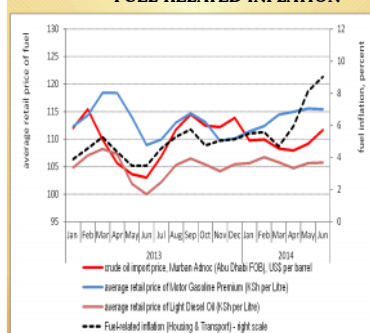
TABLE 3.1: CONSUMER PRICE INDEX, 12-MONTH INFLATION AND ANNUAL AVERAGE INFLATION (%)

	2013							2014					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Kenya CPI, Feb 2009=100	139.6	139.9	140.3	142.8	142.7	143.1	143.9	145.4	146.0	146.6	148.2	149.7	149.9
12-month overall inflation, percent	4.91	6.02	6.67	8.29	7.76	7.36	7.15	7.21	6.86	6.27	6.41	7.30	7.39
Annual average inflation, percent	4.56	4.44	4.50	4.75	5.05	5.39	5.72	6.01	6.21	6.39	6.58	6.85	7.05

Sources: Kenya National Bureau of Statistics and Central Bank of Kenya

Fuel inflation rose by 553 basis points from 3.5 percent in June 2013 to 9.0 percent in June 2014. The rise is reflected in 12-month change in the 'Transport' index which rose to 12.5 percent in June 2014 from 2.5 percent in June 2013 and in the 12-month change in the 'Housing, Water, Electricity, Gas and other Fuels' index which rose to 7.2 percent in June 2014 from 4.0 percent in June 2013. The rise in domestic fuel inflation is attributed to the increase in international oil prices, depreciation of the Kenya shilling and unfavourable weather conditions that impacted negatively on production of cheaper hydro-electricity. The international price of murban crude oil rose from US\$103.0/barrel in June 2013 to US\$ 111.7/barrel in June 2014 as shown in Chart 3B. Consequently, the average domestic retail price of motor gasoline premium rose from Kshs 108.9 per litre in June 2013 to Kshs 115.4 per litre in June 2014, while the average domestic retail price of light diesel rose from 100.0 per litre in June 2013 to 105.7 per litre in June 2014.

CHART 3B: TRENDS IN FUEL PRICES AND FUEL RELATED INFLATION



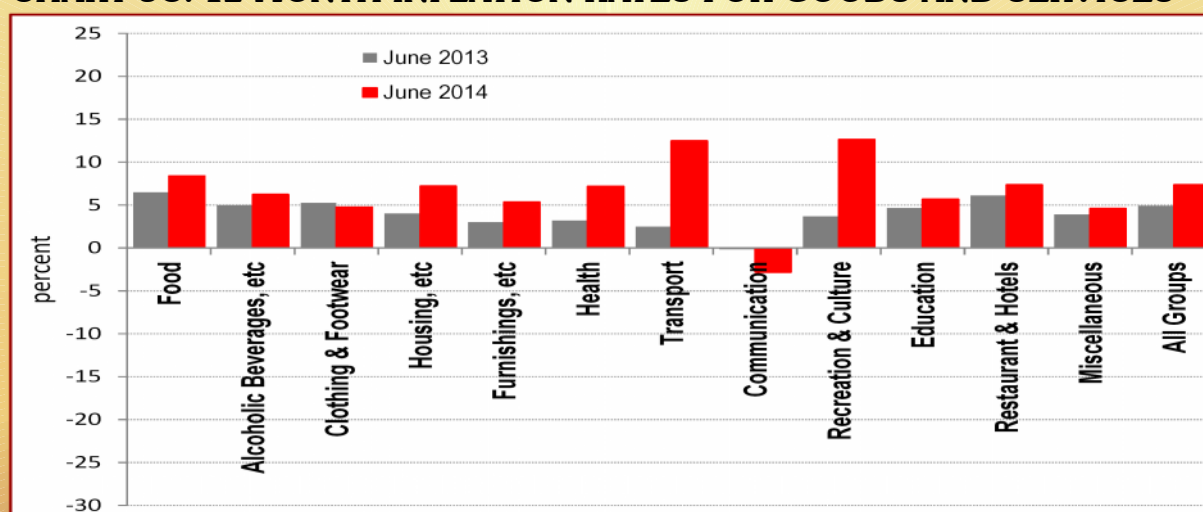
Source: Kenya National Bureau of Statistics

Food inflation rose during the period under review to 8.3 percent in June 2014 from 6.5 percent in June 2013. The increase in food inflation reflects the 12-month change in the 'Food and Non-Alcoholic Beverages' and 'Restaurants and Hotels' indices from 6.5 percent and 6.1 percent, respectively,

in June 2013 to 8.4 percent and 7.4 percent, respectively in June 2014. The surge in food inflation in September 2013 and correction thereafter coincides with implementation of the revised value added tax rates (Chart 3A).

Non-food, non-fuel inflation rose from 3.9 percent in June 2013 to 4.5 percent in June 2014 as shown in Chart 3A. This was reflected in the rise in prices of 'Recreation and Culture', 'Health', 'Furnishings, Household Equipment and Routine Household Maintenance', 'Alcoholic Beverages, Tobacco and Narcotics', 'Education' and 'Miscellaneous Goods and Services' baskets of consumption goods by 12.7 percent, 7.2 percent, 5.4 percent, 6.3 percent, 5.7 percent, and 4.6 percent, respectively in June 2014 (Chart 3C). 12-month inflation in 'Clothing and Footwear' and 'Communication' consumption baskets, however, declined to 4.8 percent and -2.8 percent respectively, in June 2014.

CHART 3C: 12-MONTH INFLATION RATES FOR GOODS AND SERVICES



Sources: Kenya National Bureau of Statistics and Central Bank of Kenya

In the period under review, the inflationary pressures in the urban centres outside of Nairobi were higher at 8.2 percent compared with the urban centres in Nairobi where 12-month inflation of 6.2 percent was recorded (Table 3.2). Inflationary pressures both within Nairobi and outside Nairobi was largely reflected in the prices of transport, recreation and culture (this includes television sets, radios and entry fees to entertainment venues), food, housing and utilities.

TABLE 3.2: 12-MONTH INFLATION ACROSS INCOME GROUPS (NAIROBI) BY LOCATION JUNE 2014

	Nairobi			Total Nairobi	Rest of Kenya
	lower income	middle income	upper income		
Food & Non-Alcoholic Beverages	6.9	9.1	10.1	7.5	9.0
Alcoholic Beverages, Tobacco & Narcotics	6.5	5.6	3.2	6.2	6.3
Clothing & Footwear	4.0	3.4	12.2	4.2	5.2
Housing, Water, Electricity, Gas & other Fuels	6.3	5.4	3.4	6.0	8.1
Furnishings, Household Equipment & Routine Household Maintenance	2.7	8.7	3.4	4.2	6.2
Health	5.8	6.2	1.0	5.7	8.3
Transport	10.0	8.5	11.4	9.8	14.6
Communication	-8.6	-9.1	0.0	-8.4	0.8
Recreation & Culture	12.9	13.4	9.6	12.9	12.5
Education	5.2	4.4	9.6	5.1	6.1
Restaurant & Hotels	3.5	3.2	5.6	3.5	10.2
Miscellaneous Goods & Services	4.1	2.9	5.0	3.9	5.1
All Groups	6.1	6.1	7.8	6.2	8.2

Source: Kenya National Bureau of Statistics & Central Bank of Kenya

Inflationary pressures due to supply side factors rose in the fiscal year 2013/14 as shown in Table 3.3. The average contribution of inflation in the 'Food and Non-Alcoholic Beverages' category to overall inflation rose from 29.0 percent in fiscal year 2012/13 to 53.6 percent in fiscal year 2013/14, while the average contribution of inflation in the 'Transport' category to overall inflation also rose from 6.4 percent to 9.2 percent during the period in review. The contributions of inflation associated with items not related to food and fuel largely declined reflecting the prudent monetary policy stance and measures implemented during the fiscal year 2013/2014, which aimed to achieve the desired level of inflation of 5.0 percent.

TABLE 3.3: AVERAGE CONTRIBUTIONS TO OVERALL 12-MONTH INFLATION, PERCENT

	FY 2012/13	FY 2013/14
Food & Non-Alcoholic Beverages	29.0	53.6
Housing, Water, Electricity, Gas & other Fuels	20.6	12.6
Transport	6.4	9.2
Clothing & Footwear	10.2	4.8
Restaurants & Hotels	8.9	4.8
Furnishings, Household Equipment & Routine Household Maintenance	7.3	4.0
Recreation & Culture	2.7	3.1
Miscellaneous Goods & Services	5.4	2.7
Health	2.7	2.3
Alcoholic Beverages, Tobacco & Narcotics	2.4	2.1
Education	3.7	1.9
Communication	0.7	-1.0

Source: Kenya National Bureau of Statistics & Central Bank of Kenya

Inflation Outlook

Overall 12-month inflation rose in the fiscal year 2013/2014 due to rising fuel prices. The adverse effects of depressed and poorly distributed rainfall on supply side conditions are expected to carry over into the fiscal year 2014/15 and put upward pressure on food prices and energy costs. Stabilization of the Kenya shilling exchange rates will however help to contain domestic inflation within target limits. There could, however, be some pressures emanating from increased volatility in international oil prices.

4. MONEY AND CREDIT DEVELOPMENTS

Monetary Policy for FY 2013/14

The Central Bank conducted monetary policy focused on achieving and maintaining stability in the general level of prices in the economy. In this regard, the monetary policy aimed to achieve the inflation target of 5 percent set by the Minister for Finance for the fiscal year 2013/14. Besides setting the inflation target, the National Treasury also projected total output growth at 5.5 percent in the fiscal year 2013/14. Accordingly, the Central Bank set out the optimal path for both reserve money and money supply expansion consistent with Government's inflation target and the expected economic growth. Money supply, M3, and reserve money were targeted to grow by 15.0

TABLE 4.1: GROWTH TARGETS FOR KEY AGGREGATES FOR 2013/14 MONETARY PROGRAMME

	Jun'13	Sept'13	Dec'13	Mar'14	Jun'14
Broad money supply (M3) (Ksh billion)	1,846.1	1,907.4	1,968.8	2,026.8	2,093.8
Reserve money (Ksh billion)	282.6	288.5	304.3	317.0	322.7
NFA of CBK (Ksh billion)	338.1	353.3	369.3	415.7	472.2
Memo:					
Annual change in reserve money	9.8	11.4	3.6	10.2	12.3
Annual change in broad money (M3)	15.8	14.1	14.0	15.4	15.0
Real GDP growth	5.3		5.1		5.5
GDP Deflator	9.1		5.3		6.5

Source: Central Bank of Kenya

percent and 12.3 percent, respectively, in the year to June 2014 (Table 4.1).

The Central Bank Rate (CBR) was the main instrument used to signal the direction of monetary policy stance and was reviewed and announced at least every two months. The movement in the CBR guided the money market participants on the direction of short term interest rates. The monetary policy stance, as signaled by the movements in the CBR, was operationalized through open market operations and the Central Bank Standing Facility (Central Bank Overnight Discount Window). The CBR continued as the reference rate for pricing monetary policy operations. Whenever the Central Bank injected liquidity in the market through a Reverse Repo, the CBR was the lowest acceptable rate. Similarly, whenever the Bank undertook to withdraw liquidity through a Vertical Repo, the CBR was the highest rate that the Central Bank paid on any bid received. Those banks utilizing the Central Bank Overnight Window were

charged the CBR plus a high penalty, currently set at 600 basis points.

During the financial year 2013/14, the Monetary Policy Committee (MPC) retained the CBR at 8.5 percent since May 2013 to continue anchoring inflationary expectations and maintain price stability. The MPC noted in its bi-monthly meetings, that the monetary policy measures adopted continued to support price stability and exchange rate stability. Both measures of inflation were largely within the Government medium-term target (± 250 basis points from 5 percent). Month-on-month overall inflation increased to 7.4 percent in June 2014 from 4.9 percent in June 2013, and the non-food non-fuel inflation to 4.47 percent from 3.86 percent in the period under review. The increase in overall inflation was mainly driven by a base effect and increase in prices of some food items, fuel and electricity.

The Kenya Shilling exchange rate was largely stable against major world currencies following increased foreign exchange flows from the Diaspora, increased foreign investor participation in the Nairobi Securities Exchange, Central Bank purchases of foreign exchange in the interbank market, US dollar drawing under the economic programme supported by the IMF's Extended Credit Facility (ECF) and increased confidence following successful issuance of the sovereign bond in June 2014. The Shilling however, depreciated against the US dollar in June 2014 to trade at an average of Ksh 87.61 per US dollar compared to an average of Ksh 85.49 per US dollar in June 2013. The depreciation of the shilling was attributed to seasonal pressures, especially payment of corporate dividends abroad towards June 2014 and subdued inflows from domestic exports.

The monetary programme implemented by the Bank was consistent with targets outlined in the ECF where the Net International Reserves (NIR) and Net Domestic Assets (NDA) were the quantitative performance criteria. The IMF Executive Board completed the final review of the ECF supported economic programme and approved the disbursement of the last tranche of SDR 71.921 million in December 2013. Disbursement of the final tranche brought total disbursements under the programme to SDR 488.52 million (or USD 748.4 million). Overall, Central Bank largely remained within the NIR and NDA targets through June 2014. The NIR under-performed in June 2014 following

**TABLE 4.2: PERFORMANCE OF MONETARY PROGRAMME
INDICATIVE TARGETS ON NDA AND NIR**

	NDA Ksh Billion)			NIR (US\$ Million)		
	1. Target (ceiling)	2. Actual (avg)	3. Deviation (=2-1)	4. Target (floor)	5. Actual (avg)	6. Deviation (=5-4)
Sep-13	-35.0	-113.1	-78.1	4,250.0	4,962.5	712.5
Dec-13	-10.0	-93.7	-83.7	4,350.0	5,029.8	679.8
Mar-14	-98.6	-117.5	-18.9	5,018.0	5,152.4	134.4
Jun-14	-98.4	-125.5	-27.1	5,082.0	5,016.0	-66.0

Source: Central Bank of Kenya

sale of foreign exchange in the interbank market to minimize exchange rate volatility (Table 4.2)

The successful conclusion of the ECF supported economic programme is a clear demonstration of the Government's commitment to sound economic policies and structural reforms. During the final review, the IMF Executive Board observed that Kenya's macroeconomic conditions had improved considerably especially the external and fiscal positions owing to far-reaching economic and structural reforms implemented by the Government. They further noted that Kenya was better placed to withstand shocks and tap into international financial markets.

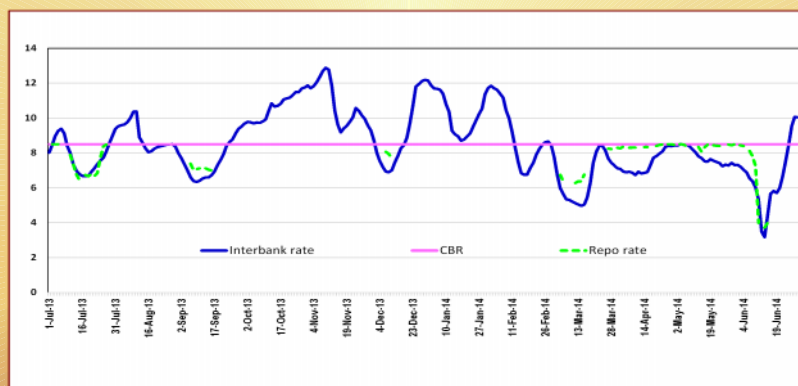
Monetary Policy Implementation

To implement monetary policy, the Central Bank relied on open market operations (OMOs) mainly repurchase order agreement securities (REPOs) and term auction deposits (TAD) and sale of foreign exchange in the interbank market to stabilize volatility in the exchange rate. During the FY 2013/14 the Central Bank actively used open market operations to sterilize excess liquidity in the market and reduce volatility in the interbank rate. Commercial banks' holding of repos and term auction deposits rose from Ksh 10.0 billion on March 5, 2014 to Ksh 50.0 billion on June 4, 2014 and thereafter declined to Ksh 1.3 billion by June 26, 2014. The excess liquidity was occasioned by net redemptions of government securities. In the period, the Bank cautiously sold and purchased foreign exchange from the interbank market to stabilize the exchange rate.

The short term money market interest rates largely oscillated around the CBR (Chart 4A) and interbank rate decreased from an average of 7.14 percent in June 2013 to 6.60 percent in

June 2014. However, there were occasions when the interbank rate exhibited excessive volatility. The upward pressure from September through November 2013 and in January 2014 was due to tight liquidity conditions in the money market. The downward pressure on the interbank rate in March 2014 and June 2014 was due to excess liquidity derived from net redemptions of government securities. The liquidity management committee utilized open market operations (OMO) to minimize volatility in the interbank rate and restore it within the CBR corridor.

CHART 4A: REPO AND INTERBANK RATES JULY 2013 TO JUNE 2014



Source: Central Bank of Kenya

Money Supply

Growth of broad money supply, M3, increased to 18.2 percent in the year to June 2014 from 14.2 percent in the year to June 2013, and was above the projected target of 15.0 percent for the year to June 2014. The broad money supply growth was attributed to increases in the Net Foreign Assets (NFA) of the

**TABLE 4.3: PERFORMANCE OF MONETARY AGGREGATES
JUNE 2013 - JUNE 2014 (PERCENT)**

	RM		M3		Private Sector Credit	
	Act.	Targ.	Act.	Targ.	Act.	Targ.
2013						
Jan	12.2	17.3	14.9	16.8	12.0	17.0
Feb	23.9	23.3	16.2	18.1	11.6	13.7
Mar	11.5	8.8	15.7	17.8	11.2	13.7
Apr	9.5	14.6	17.6	17.6	10.5	14.1
May	18.9	18.1	17.0	17.0	9.5	14.3
Jun	11.7	9.8	14.2	15.8	12.7	15.7
2014						
Jan	10.3	17.6	17.1	14.2	20.5	18.2
Feb	9.9	8.6	16.2	14.7	21.5	18.6
Mar	8.5	10.2	17.3	15.4	22.7	17.7
Apr	18.1	20.6	16.6	13.7	23.9	18.2
May	17.3	13.6	17.8	13.6	25.0	18.3
Jun	12.6	12.3	18.2	15.0	25.8	18.2

Source: Central Bank of Kenya

banking system and increased growth in private sector credit (Table 4.3 and 4.4).

NFA of the banking system increased by 46.6 percent from Ksh 361.2 billion in June 2013 to Ksh 529.5 billion in June 2014 and was reflected in the holdings of the Central Bank. NFA of the Central Bank increased by 53.1 percent from Ksh 402.1 billion in June 2013 to Ksh 615.5 billion in June 2014. Over the same period, NFA of banking institutions decreased by Ksh 45.1 billion from -40.9 billion in June 2013 to Ksh -86.0 billion in June 2014 on account of increase in loans borrowed from non-residents and other accounts payable. Meanwhile, annual growth of the NDA of the banking sector decreased to 11.1 percent in the year to June 2014 from 14.6 percent over a similar period 2013 reflecting a reduction in other domestic assets of the banking system and accumulation of government deposits (Table 4.4) at the Central Bank. The delay in implementing required payment struc-

TABLE 4.4: MONEY SUPPLY AND ITS SOURCES (KSH BILLION)

	Jun 2012 Act	Jun 2013 Act	Jun 2014 Act	Absolute Change		Annual % Change	
				2012/13	2013/14	2012/13	2013/14
1.0 Liabilities							
Money Supply							
Money supply, M2	1,339.5	1,547.9	1,834.4	208.4	286.5	15.6	18.5
Money supply, M3	1,595.1	1,820.9	2,151.5	225.8	330.6	14.2	18.2
Overall Liquidity, L	1,971.1	2,278.3	2,717.7	307.2	439.4	15.6	19.3
2.0 Assets (2.1+2.2)	1,594.7	1,820.6	2,151.5	226.0	330.8	14.2	18.2
2.1 Net foreign assets	321.8	361.2	529.5	39.4	168.3	12.3	46.6
Central Bank	330.5	402.1	615.5	71.7	213.4	21.7	53.1
Banking Institutions	-8.7	-40.9	-86.0	-32.2	-45.1		
2.2 Net domestic assets (2.21+2.22)	1,273.3	1,459.7	1,622.0	186.4	162.3	14.6	11.1
2.21 Domestic Credit (2.210+2.211)	1,552.3	1,783.0	2,042.9	230.6	260.0	14.9	14.6
2.210 Government (net)	297.9	379.5	283.1	81.6	-96.4	27.4	-25.4
2.211 Other public sector	41.2	36.2	40.0	-5.0	3.8	-12.1	10.5
2.212 Private sector	1,213.2	1,367.2	1,719.8	154.0	352.6	12.7	25.8
2.22 Other assets net	-279.5	-323.3	-421.0	-43.8	-97.7		
Memorandum Item:							
Reserve Money	257.3	287.4	323.7	30.2	36.3	11.7	12.6

Source: Central Bank of Kenya

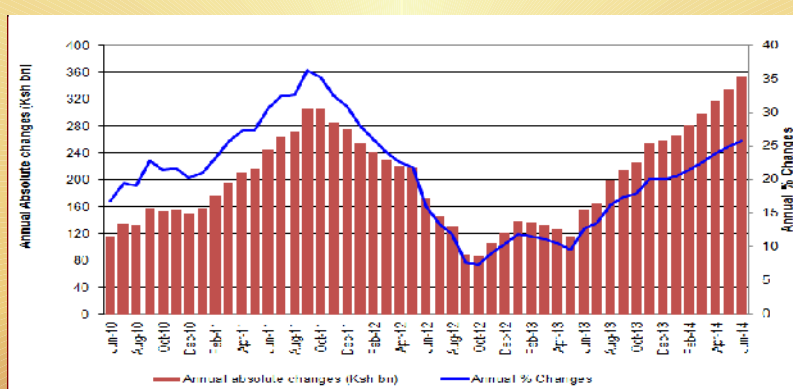
tures under the devolved system of government explain the reduced absorption by governments at the national and county levels.

Domestic Credit

Domestic credit grew by Ksh 260.0 billion (14.6 percent) compared with Ksh 230.6 billion (14.9 percent) in the year to June 2013. Net credit to the Government decreased by 25.4 percent from Ksh 379.5 billion in the year to June 2013 to Ksh 283.1 billion in the year to June 2014. Credit extended to the private sector increased by Ksh 352.6 billion (25.8 percent) in the year to

June 2014 compared to Ksh 154.0 billion (12.7 percent) in the year to June 2013 and was above the growth target of 18.2 percent in June 2014 (Table 4.5 and Chart 4B). The increase in private sector credit growth was on account of sustained macro- economic stability and a base effect related to subdued demand attributed to monetary policy tightening since October 2011 to contain inflationary pressures. Despite the commencement of monetary policy easing from July 2012 demand for private sector credit remained subdued through to June 2013, partly impacted by uncertainty and dip in business confidence associated with the general elections conducted in March 2013.

CHART 4B: ANNUAL PERCENTAGE CHANGES IN PRIVATE SECTOR CREDIT



Source: Central Bank of Kenya

However, the private sector continued to dominate banking sector credit and accounted for 84.2 percent of total lending in June 2014 compared with the net credit to the government which accounted for 13.9 percent.

TABLE 4.5: DOMESTIC CREDIT (KSH BN)

	2013 June		2014 June		Annual Change		Share of private sector credit expansion (%)
	Ksh bn	Share (%)	Ksh bn	Share (%)	Ksh bn	(%)	
1. Credit to other public sector	36.2	2.0	40.0	2.0	3.8	10.5	
Local government	-3.0	-0.2	3.1	0.2	6.0	-203.7	
Parastatals	39.2	2.2	36.9	1.8	-2.2	-5.7	
2. Credit to private sector	1367.2	76.7	1719.8	84.2	352.6	25.8	100.0
Agriculture	55.3	3.1	65.3	3.2	9.9	17.9	2.8
Manufacturing	167.9	9.4	221.1	10.8	53.2	31.7	15.1
Trade	227.9	12.8	283.5	13.9	55.6	24.4	15.8
Building and construction	65.9	3.7	75.8	3.7	9.9	15.1	2.8
Transport & communications	77.2	4.3	111.4	5.5	34.2	44.3	9.7
Finance & insurance	29.6	1.7	38.9	1.9	9.3	31.2	2.6
Real estate	176.6	9.9	225.1	11.0	48.5	27.5	13.8
Mining and quarrying	21.8	1.2	28.5	1.4	6.7	30.7	1.9
Private households	207.4	11.6	266.2	13.0	58.8	28.3	16.7
Consumer durables	85.4	4.8	103.0	5.0	17.6	20.6	5.0
Business services	117.5	6.6	162.4	7.9	44.9	38.2	12.7
Other activities	134.6	7.5	138.7	6.8	4.1	3.0	1.2
3. TOTAL (1+2) *	1783.0	100.0	2042.9	100.0	260.0	14.6	

Source: Central Bank of Kenya

The major recipients of private sector credit were, in order of magnitude the following: private households (16.7 percent), trade (15.8 per cent), manufacturing (15.1 percent), real estate (13.8 percent), business services (12.7 percent), and transport and communication (9.7 percent) (Table 4.5).

Reserve Money

Reserve money, which comprises currency in circulation and commercial banks deposits at the Central Bank, increased by Ksh 36.3 billion (12.6 percent) to Ksh 323.7 billion in June 2014 from Ksh 287.4 billion in June 2013. The increase in reserve money reflected Ksh 10.2 billion (6.9 percent) growth in currency outside banks and Ksh 26.1 billion (18.7 percent) in bank reserves. At Ksh 323.7 billion in June 2014, reserve money was Ksh 1.0 billion above target.

The sources of reserve money in the year to June 2014 were increases in the net foreign assets (NFA) of the Central Bank. NFA of the Central Bank rose by Ksh 213.4 billion (53.1 percent) to Ksh 615.5 billion in the year to June 2014 reflecting build-up of official foreign exchange reserves partly with purchases from commercial banks.

The NDA of the Central Bank declined by Ksh 177.1 billion to Ksh -291.8 billion in the year to June 2014, from Ksh -114.7 billion in the previous year. This was reflected in the reduction of net claims on Government on account of build-up of government deposits. Net government borrowing from the Central Bank

TABLE 4.6: RESERVE MONEY AND ITS SOURCES (KSH BN)

	2012	2013	2014	Absolute Change		%age Change (%)		2014	Deviation
	June	June	June	2012/13	2013/14	2012/13	2013/14	June Target	
1. Net Foreign Assets	330.5	402.1	615.5	71.7	213.4	21.7	53.1	472.2	143.3
2. Net Domestic Assets	-73.2	-114.7	-291.8	-41.5	-177.1	56.7	154.4	-149.5	-142.3
2.1 Government Borrowing (net)	10.7	-20.9	-176.0	-31.5	-155.2	-295.9	743.5	-40.1	-140.2
2.2 Advances & Discounts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-44.8	44.8
2.3 Other Domestic Assets (net)	-50.6	-56.0	-119.4	-5.4	-63.4	10.7	113.2	-64.5	-50.6
3. Reserve Money	257.3	287.4	323.7	30.2	36.3	11.7	12.6	322.7	1.0
3.1 Currency outside banks	126.9	148.0	158.2	21.0	10.2	16.6	6.9	160.3	-2.1
3.2 Bank reserves	130.3	139.5	165.6	9.1	26.1	7.0	18.7	162.4	3.1

Source: Central Bank of Kenya

decreased by Ksh 155.2 billion to close at Ksh -176.0 billion in June 2014 compared to Ksh -20.9 billion in June 2013. Other domestic assets of the Central Bank decreased by Ksh 63.4 billion to Ksh -119.4 billion from Ksh -56.0 billion in June 2013 (Table 4.6).

Outlook

Over the next twelve months to June 2015, the Bank will target 15.6 percent expansion in broad money supply, M3, and 14.4 percent increase in reserve money (Table 4.7). The liquidity supply in the Monetary Programme will support 6.1 percent growth in domestic production of goods and services by June 2015. Inflation as measured by the GDP deflator is projected to

TABLE 4.7: MONETARY PROGRAMME FOR 2014/15

	Jun-13	Jun-14
	Act.	Proj.
Ksh Billion		
Reserve Money	323.7	370.4
Net Foreign assets	529.4	514.6
Money Supply (M3)	2,152.1	2,488.1
Annual Growth Rates		
Money Supply (M3)	18.2	15.6
Reserve Money	12.6	14.4
Credit to Private Sector	25.8	18.2
Real GDP	5.2	6.1
GDP deflator	6.9	7.4
Months of import cover	5.7	5.2

Source: Central Bank of Kenya

increase from 6.9 percent in June 2014 to 7.4 percent in June 2015 while credit provision to private sector is projected at 18.2 percent in June 2015, a slowdown from 25.8 percent growth in June 2014. The Bank will continue to use open market operations to implement monetary policy.

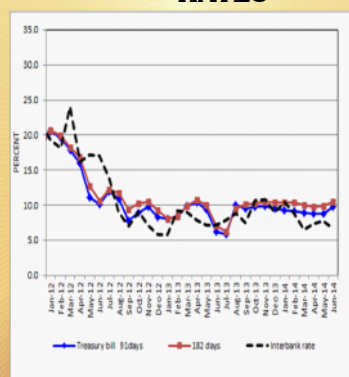
Central Bank Rate (CBR)

The Monetary Policy Committee held the Central Bank Rate (CBR) at 8.5 percent since May 2013 in order to continue anchoring inflationary expectations and price stability.

Short-Term Rates

The CBR coordinated the movements in short-term interest rates (Table 5.1 and Chart 5A). The average interbank rate decreased from 7.14 percent in June 2013 to 6.60 percent in June 2014, while the repo rate decreased from 7.93 in June 2013 percent to 6.46 percent in June 2014. The easing of the average interbank rate reflects improved market liquidity supported by net redemptions of Government securities.

CHART 5A: SHORT TERM INTEREST RATES



Source: Central Bank of Kenya

The 91-day Treasury bill rate increased from 6.21 percent in June 2013 to 9.81 percent in June 2014, and the 182-day Treasury bill rate increased from 7.12 percent to 10.50 percent. A higher borrowing requirement by government explain the rise in short term interest rates in June 2014.

Lending Rates

Commercial banks' lending rates remained fairly stable in the year to June 2014. The average lending rate fell from 16.97 percent in June 2013 to 16.36 percent in June 2014. The marginal decrease in the overall lending rate was reflected in all loan categories (overdraft, 1-5 years and over 5 years loans) for both the corporate and business loans (Table 5.1). The stability of commercial bank lending rates was consistent with the prudent monetary policy stance as reflected in stable CBR.

TABLE 5.1: INTEREST RATES (%)

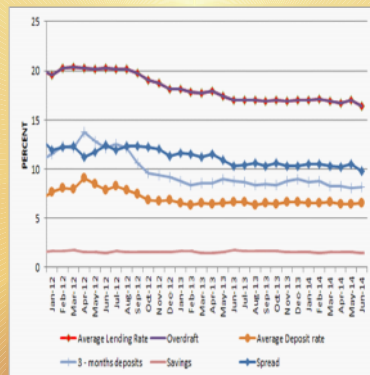
	2013							2014					
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Treasury bill 91-day	6.21	5.92	10.03	9.58	9.72	9.94	9.52	9.26	9.16	8.98	8.80	8.82	9.81
Treasury bill 182-day	7.12	6.23	9.57	10.15	10.28	10.54	10.41	10.36	10.35	10.08	9.83	9.86	10.50
Average Lending Rate	16.97	17.02	16.96	16.86	17.00	16.89	16.99	17.03	17.06	16.91	16.70	16.97	16.36
Overdraft	16.92	17.00	16.89	16.42	16.96	16.50	16.51	16.82	16.88	16.44	16.44	17.85	15.88
Interbank rate	7.14	7.93	8.88	7.52	10.66	10.77	8.98	10.43	8.83	6.47	7.40	7.76	6.60
Average Deposit rate	6.65	6.59	6.36	6.55	6.43	6.61	6.65	6.55	6.57	6.61	6.48	6.42	6.56
3 - months deposits	1.86	1.84	1.95	2.01	2.08	2.09	1.98	2.06	2.05	2.08	2.24	2.33	2.30
Savings	1.73	1.64	1.67	1.64	1.63	1.58	1.58	1.56	1.49	1.56	1.53	1.54	1.50
Spread	10.32	10.43	10.60	10.32	10.57	10.28	10.34	10.48	10.49	10.30	10.23	10.55	9.80

Source: Central Bank of Kenya

Deposit Rates

Average commercial banks' deposit rate decreased marginally to 6.56 percent in June 2014 from 6.65 percent in June 2013. The decrease in the average deposit rate was reflected in the 0-3 months and 'savings' categories which decreased by 65 basis points and 22 basis points from 8.77 percent and 1.73 percent in June 2013 to 8.12 percent and 1.50 percent in June 2014, respectively.

The change in the overall lending rate and overall deposits rate in the year to June 2014 was minimal, thus the interest rate spread narrowed from 10.32 percent in June 2013 to 9.80 percent in June 2014. Chart 5A and 5B, and Table 5.1 show the movement in interest rates during the period.

CHART 5B: COMMERCIAL BANKS' AVERAGE INTEREST RATES

Source: Central Bank of Kenya

Interest Rates Outlook

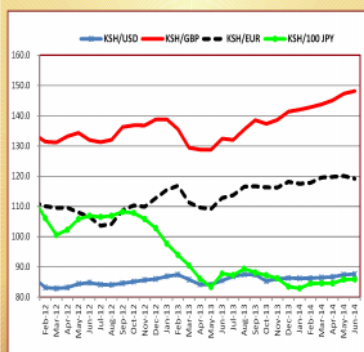
The Central Bank of Kenya continues to support interest rate stability and effective from July 8, 2014, the Central Bank introduced the Kenya Bank's reference rate (KBRR) to enhance transparency in the pricing of credit by commercial banks. The KBRR rate is based on Central Bank rate and treasury bills rate and all banks and mortgage finance companies are expected to disclose the premium above the base rate. This is expected to increase transparency in bank lending and to enhance transmission between the Central Bank Rate and bank's lending rate and ultimately enhance the supply of private sector credit.

6. EXCHANGE RATES

The Kenya shilling exchange rate remained stable against major world currencies during FY 2013/14 (Chart 6A and Table 6.1) supported by increased remittances from the Diaspora, IMF disbursements under the Extended Credit Facility programme and the Central Bank's activities in the Foreign Exchange markets.

During the period under review, the Kenya shilling exchange rate strengthened by 12.65 percent to the Japanese Yen but weakened marginally by 1.65 percent to the US Dollar, 5.3 percent to the Pound Sterling and 6.58 percent to the Euro to trade at an average of 86.68 per USD, 140.89 per Pound Sterling, 117.56 per Euro and 85.88 per 100 Japanese Yen. The weakening of the Kenya shilling against the Euro and the Pound Sterling reflects the weakening of the US dollar against those currencies. Against the regional currencies, the shilling depicted mixed performance, strengthening to the Rwanda and Burundi francs as well as the South African Rand but weakening marginally to the Uganda and Tanzania shillings (Table 6.1 and Chart 6A). The weakening of the South African Rand was mainly attributed to the news of US tapering of the bond purchases early in the year, labour unrests in the platinum mining sector and concerns about sustainability unrests.

CHART 6A: KENYA SHILLING EXCHANGE RATES



Source: Central Bank of Kenya

TABLE 6.1: KENYA SHILLING EXCHANGE RATES

	FY				% change FY 2012-13/2013-14
	2010-11	2011-12	2012-13	2013-14	
KSH/USD	82.46	88.83	85.27	86.68	1.65
KSH/GBP	131.17	140.74	133.80	140.89	5.30
KSH/EUR	112.51	119.24	110.30	117.56	6.58
KSH/100 JPY	99.33	112.83	98.31	85.88	-12.65
KSH/ZAR	11.78	11.48	9.67	8.35	-13.64
USH/KSH*	28.18	28.83	30.36	29.18	-3.90
TSH/KSH*	18.31	18.29	18.80	18.69	-0.57
RWF/KSH*	3.40	6.81	7.31	7.69	5.25
BIF/KSH*	6.99	14.63	17.66	17.79	0.72

* Units of currency per Kenya Shilling

Source: Central Bank of Kenya

International Trade Competitiveness

On average, Nominal Effective Exchange Rate (NEER), depreciated by 0.73 percent to an indexed level of 116.72 in the Fiscal Year 2013/14 compared to an indexed level of 115.87 in the Fiscal Year 2012/13 largely reflecting the weakening of the Kenya shilling to the majority of the trading partner currencies. In spite of the depreciation, the NEER remained stable during the period with the stability largely supported in the bilateral exchange rates. The Real Effective Exchange Rate (REER), which measures Kenya's competitiveness compared to its main trading partners appreciated by 4.03 percent from an average index level of 65.37 during FY 2012/13 to an average index level of 62.74 during the FY 2013/14 with the appreciation reflecting a higher domestic rate of inflation relative to foreign inflation.

Outlook for the Kenya Shilling

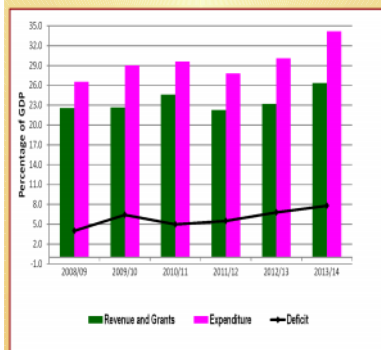
The exchange rate is expected to remain stable during the fiscal year 2014/15 in spite of the continued pressure from the current account of the balance of payments. Factors influencing exchange rate stability include expected macroeconomic stability in 2014 on account of projected stable low inflation, stable interest rates and a possible restraint in domestic government borrowing thus creating a conducive environment for improved economic growth. World trade volume is projected to expand to 4 percent in 2014 and 5.3 percent in 2015 (World Economic Outlook, July 2014 update) supported by increased global demand which may in turn increase demand for Kenya's exports. A projected increase in global economic growth by 3.4 percent in 2014 and 4 percent in 2015 (World Economic Outlook, July 2014 update) is likely to impact positively on the Kenyan economy more so on inflows from Diaspora remittances and foreign investments. In addition, recent discoveries of oil and gas are likely to trigger an increase in Foreign Direct investment.

Risks to the outlook however, include balance of payments pressures attributed to the high current account deficit; inflationary risks associated with erratic rains posing a threat to electricity and water supply leading to higher costs of energy; risks to the tourism sector arising from insecurity concerns, which may lead to the underperformance of the sector, thus affecting foreign currency inflows.

FISCAL POLICY MANAGEMENT

7. GOVERNMENT BUDGETARY OPERATIONS

CHART 7A: GOVERNMENT BUDGET PERFORMANCE



Sources: Central Bank of Kenya and National Treasury

Government budgetary operations in the fiscal year 2013/14 resulted in a budget deficit of Ksh 296.4 billion or 6.2 percent of GDP on commitment basis, compared with Ksh 240.7 billion or 5.7 percent of GDP reported in a similar period in the fiscal year 2012/13. The deficit, however, remained within the revised target of Ksh 391 billion or 8.2 percent of GDP for the FY 2013/14 (Table 7.1 and Chart 7A). During the year under review, 68.8 percent of budget financing came from domestic sources, compared with 42.5 percent and 76.3 percent in the fiscal years 2011/12 and 2012/13, respectively.

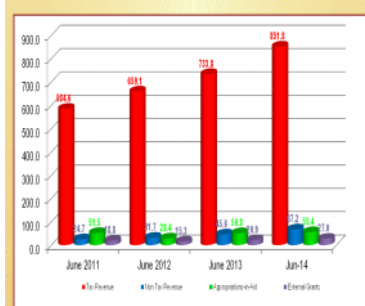
TABLE 7.1: STATEMENT OF CENTRAL GOVERNMENT OPERATIONS
Ksh (Billion)

	FY 2009/2010	FY 2010/2011	FY 2011/2012	FY 2012/2013	FY 2013/14		
	Actual	Actual	Actual	Actual	Provisional	Rev. Target	Over(+)/ Below (-)
1. REVENUE & GRANTS	560.8	679.5	734.4	866.5	1001.4	1060.1	-58.7
Revenue	543.8	660.8	719.1	845.1	974.4	1006.4	-32.0
Tax Revenue	487.7	584.6	659.1	701.2	851.8	850.4	1.4
Non Tax Revenue	19.7	24.7	31.7	76.2	67.2	67.6	-0.4
Appropriations-in-Aid	36.3	51.5	28.4	67.8	55.4	88.4	-33.0
External Grants	17.0	18.8	15.3	21.4	27.0	53.7	-26.8
2. EXPENDITURE AND NET LENDING	718.6	817.1	915.9	1107.2	1297.8	1451.1	-153.3
Recurrent Expenditure	519.8	581.4	639.1	812.0	785.1	844.4	-59.4
Development Expenditure	198.8	235.6	276.8	295.2	319.3	413.2	-93.9
County Transfers	0.0	0.0	0.0	9.8	193.4	193.4	
3. DEFICIT ON A COMMITMENT BASIS (1-2)	-157.8	-137.6	-181.5	-240.7	-296.4	-391.0	94.6
Deficit on a commitment basis as a % of GDP*	-5.5	-4.3	-5.5	-5.7	-6.2	-8.2	
4. ADJUSTMENT TO CASH BASIS	-9.0	19.7	0.0	0.1	-12.7	0.0	-12.7
5. DEFICIT ON A CASH BASIS	-166.8	-117.8	-181.5	-240.6	-309.1	-391.0	81.8
Deficit on a cash basis as a % of GDP*	-5.8	-3.7	-5.5	-5.7	-6.5	-8.2	
6. DISCREPANCY: Expenditure (+)/Revenue (-)	-3.2	1.6	-8.8	-9.4	0.0	0.0	0.0
7. FINANCING	163.7	119.5	172.6	231.1	309.1	391.0	-81.8
Domestic (Net)	152.5	90.4	73.2	168.9	203.0	99.1	103.9
External (Net)	11.1	29.1	99.4	62.2	106.1	291.9	-185.7
Capital Receipts (net of restructuring costs)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: National Treasury and Central Bank of Kenya

Government Revenue

Government revenue (inclusive of grants) increased by 15.6 percent to Ksh 1,001.4 billion during the fiscal year 2013/14 from Ksh 866.5 billion in fiscal year 2012/13 (Chart 7B). The improvement was recorded in all components. As a proportion of GDP, the total cumulative revenue and grants increased from 20.4 percent during the FY 2012/13 to 21 percent during the FY 2013/14. Despite the improved revenue performance in the period under review, overall target was missed by 5.5 percent largely due to due to shortfall in Appropriation-in-Aid (A-in-A) and external grants. The shortfall in AIA reflects the

CHART 7B: COMPOSITION OF REVENUE

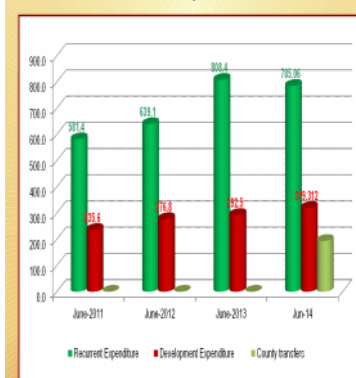
Sources: Central Bank of Kenya and National Treasury

persistent problem of under reporting of ministerial income especially university collections which are not adequately captured in the ministerial expenditure returns.

Tax revenue in fiscal year 2013/14 increased by 21.5 percent over the collection of the previous year and surpassed target by Ksh 1.4 billion or 0.1 percent. External grants received amounted to Ksh 27 billion which was below target by 49.7 percent.

Expenditure and Net Lending

Government expenditure and net lending increased by 17.2 percent, from Ksh 1,107.2 billion in the fiscal year 2012/13 to Ksh 1,297.8 billion in the fiscal year 2013/14 (Chart 7C). Development expenditures and county transfers increased by Ksh 26.9 billion and Ksh 183.6 billion, respectively. Recurrent expenditure declined by Ksh 23.3 billion and fell below target by 7 percent. All recurrent expenditures fell below targets except domestic interest payments which surpassed its target by Ksh 9.1 billion. Recurrent expenditures lower than expected due to the lag between spending at the County level and reporting at the headquarters. Development expenditure at Ksh 319.3 billion was Ksh 93.9 billion or 22.7 percent below target. The shortfall emanates from non-inclusion of expenditure from the counties as well as a lower absorption rate with respect to the externally financed projects. The largest share of development outlay was absorbed by the ministry of transport and infrastructure.

CHART 7C: GOVERNMENT EXPENDITURE

Sources: Central Bank of Kenya and National Treasury

The marginal decline in recurrent expenditure from 72.8 percent of the total expenditure in the FY 2012/13 to 60.5 percent of the total expenditure in the FY 2013/14 is consistent with the Government's fiscal policy objective of prioritizing infrastructural developments. This is in order to create a favorable business environment, and therefore, provide the investments to achieve and sustain high economic growth in line with the Vision 2030.

Financing

The budgetary operations of the Government resulted in a financing requirement of Ksh 339.1 billion during the period under review (Table 7.2). The Government obtained the funds through domestic borrowing amounting to Ksh 233.8 billion and net

external debt borrowing of Ksh 106.1 billion. The funds were allocated to bridge the Government budgetary deficit of Ksh 309.1 billion and build up government deposits by Ksh 46.2 billion. The Government accessed 68.9 percent of the funds from domestic sources via additional borrowing. The build-up

TABLE 7.2: GROSS GOVERNMENT BORROWING REQUIREMENTS AND ITS SOURCES, JULY-JUNE (KSH BN)

I. FINANCING REQUIREMENTS	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
1. Budget deficit	83.5	163.7	117.8	172.6	230.2	309.1
2. External debt reduction	-	-	-	-	-	-
3. Domestic debt reduction	6.3	-	10.8	-	11.0	-
3.1 Central Bank (incl. items in transit)	6.3	-	10.8	-	11.0	-
3.2 Commercial banks (net of deposits)	-	-	-	-	-	-
3.3 Non-bank sources	-	-	-	-	-	-
4. Increase in GoK deposits at CBK*	-	-	5.2	0.4	14.3	46.2
5. Adjustment to cash basis	-	-	3.0	-	-	15.5
TOTAL	89.8	163.7	135.9	173.0	255.5	339.0
II. FINANCING SOURCES	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
1. Budget surplus	-	-	-	-	-	-
2. External debt increase	11.6	11.9	29.1	99.4	60.5	106.1
3. Increase in domestic debt	72.4	131.1	107.7	73.6	195.1	233.8
3.1 Central Bank	-	9.8	-	7.7	-	29.3
3.2 Commercial banks	43.6	91.6	24.4	25.4	112.4	90.1
3.3 Non-bank sources	28.8	29.7	83.3	40.6	82.7	114.3
4. Reduction in GoK deposits at CBK	3.3	20.7	-	-	-	-
5. Privatisation proceeds (Net of Restructuring Costs)	2.5	-	0.9	-	-	-
TOTAL	89.8	163.7	135.9	173.0	255.5	339.9

* Increase in GoK deposits at the CBK is less the Ksh 36.3 billion deposits by the county government

Source: National Treasury and Central Bank of Kenya

of Government deposits in part mirror lower than budgeted uptake in development and County transfers.

Outlook for the fiscal year 2014/15

In the budget estimates for the FY 2014/15 ordinary revenue is estimated at Ksh 1,087.1 billion (22.9 percent of GDP) while external grants are estimated at Ksh 58.7 billion (1.2 percent of GDP). Government expenditure is estimated at Ksh 1,597.8 billion (or 33.6 percent of GDP), of which, Ksh 871.5 billion (18.3 percent of GDP) will be in recurrent expenses, transfer to the county government of Ksh 229.3 billion, a contingency fund of Ksh 5.0 billion and the balance is in development expenses

The overall budget deficit including grants on commitment basis is therefore estimated at Ksh 357.8 billion (7.5 percent of GDP) in 2014/15. The deficit is expected to be financed through net external borrowing of Ksh 165.8 billion and net domestic borrowing of Ksh 192.1 billion.

8. PUBLIC DEBT

Kenya's public and publicly guaranteed debt stood at Ksh 2,370.3 billion as at end June 2014. This represents a 25.1 percent increase from Ksh 1,894.1 billion held at the end of June 2013 (Table 8.1). The increase in the overall Government debt stock comprised Ksh 233.8 billion in domestic debt and Ksh 242.4 billion in external debt. The percentage of domestic debt to total debt declined from 55.5 percent to 54.2 percent during the period, while that of external debt increased from 44.5 percent to 45.8 percent. As a percentage of GDP, overall public debt stock increased from 44.5 percent to 49.8 percent during the period. In particular, the proportion of external debt to GDP increased from 19.8 percent to 22.8 percent, while domestic debt increased from 24.7 percent of GDP to 27.0 percent.

TABLE 8.1: PUBLIC DEBT (KSH BN)

	June 2011		June 2012		June 2013		June 2014	
	Ksh bn	%	Ksh bn	%	Ksh bn	%	Ksh bn	%
DOMESTIC DEBT								
Securitised debt	753.0	98.5	848.8	98.8	1040.8	99.1	1242.4	96.7
Treasury Bills	157.4	20.6	161.8	18.8	296.6	28.2	327.7	25.5
Of which Repo Treasury bills	30.8	4.0	29.8	3.5	28.9	2.8	28.3	2.2
Treasury Bonds	595.7	77.9	687.0	80.0	744.2	70.8	914.8	71.2
Government Stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non Securitized debt	11.2	1.5	10.0	1.2	9.8	0.9	40.6	3.2
Overdraft/Advances	9.8	1.3	7.3	1.1	7.0	0.7	37.2	2.9
Others	1.4	0.2	2.8	0.1	2.8	0.3	3.4	0.3
TOTAL DOMESTIC DEBT	764.2	100.0	858.8	100.0	1050.6	100.0	1284.3	100.0
(as a % of GDP)*	24.1		23.0		24.7		27.0	
(as a % of Total Debt)	51.2		52.9		55.5		54.2	
EXTERNAL DEBT**								
Bilateral	257.0	35.3	246.2	31.8	257.6	30.5	289.9	26.7
Multilateral	445.3	61.2	452.9	59.8	511.8	60.7	597.3	55.0
Comm. Banks	0.0	0.0	50.5	6.5	58.9	7.0	182.2	16.8
Export Credit	25.0	3.4	14.8	1.9	15.2	1.8	16.5	1.5
TOTAL EXTERNAL DEBT	727.3	100.0	764.5	100.0	843.6	100.0	1085.9	100.0
(as a % of GDP)*	22.9		20.5		19.8		22.8	
(as a % of Total Debt)	48.8		47.1		44.5		45.8	
TOTAL PUBLIC DEBT	1,491.5		1,623.4		1894.1		2,370.3	
(as a % of GDP)*	47.1		43.6		44.5		49.8	

* Estimates
** Provisional

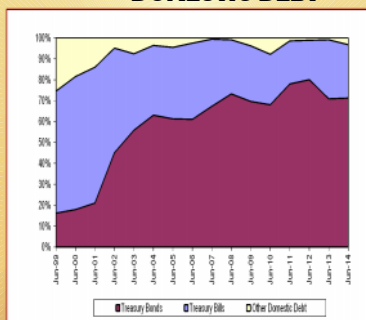
Sources: Central Bank of Kenya and National Treasury

The growth in the share of total debt in GDP to 49.8 percent in June 2014 from 44.5 percent in June 2013 is largely attributed to external debt which grew to 22.8 percent of GDP in June 2014 from 19.8 percent in June 2013. This development is attributed to the successful issuance of the debut sovereign bond amounting to Ksh 174.5 billion (US \$ 2.0 billion) during the 4th quarter of the fiscal year. In addition, the government rolled over the syndicated debt amounting to US \$ 600.00 million. There was also an elevated uptake of domestic debt uptake during the 4th quarter of the fiscal year to cater for pressing fiscal needs of government arising from implementation of various sections of the new constitution. Further more the economy performed at 5.7 percent in 2013 which was lower than anticipated. All these factors occasioned growth of the total debt to GDP during the fiscal year 2013/14.

Public Domestic Debt

Total domestic debt increased by 233.8 billion during the fiscal year 2013/14 from Ksh 1,050.6 billion in June 2013 to Ksh 1284.3 billion in June 2014, mostly as a result of increased securitized debt during the period. Total Government securities (including repos), held at the end of June 2013 amounted to Ksh 1040.8 billion compared with Ksh 1,242.4 billion held at the end of June 2014. The outstanding stock of total domestic debt as at June 2014 comprised 71.2 percent in Treasury bonds and 23.3 percent in Treasury bills (excluding repos). During the year to June 2014, total Treasury bonds increased by Ksh 170.6 billion compared with holdings of the previous year, reflecting the government debt management strategy of restructuring domestic debt to benchmark-long dated instruments in order to minimize the risks associated with short term domestic borrowing. Government overdraft facility at Central Bank, which is the main component of other domestic debt, increased from Ksh 7 billion in June 2013 to Ksh 37.2 billion in June 2014.

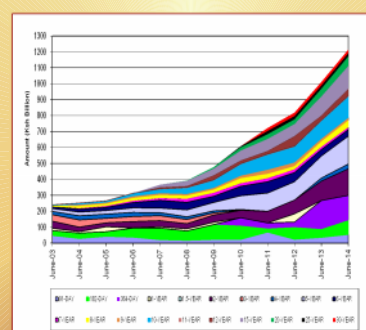
CHART 8A: COMPOSITION OF GOVERNMENT DOMESTIC DEBT



Sources: Central Bank of Kenya and National Treasury

As shown in Chart 8A, the percentage of Treasury bonds in total domestic debt increased from 70.8 percent in June 2013 to 71.2 percent in June 2014, while that of Treasury bills declined from 25.5 percent of total domestic debt to 23.3 percent during the period. Treasury bills (including Repos) increased from Ksh 296.6 billion to Ksh 327.7 billion during the period.

CHART 8B: OUTSTANDING TREASURY BILLS & BONDS BY TENOR



Sources: Central Bank of Kenya

As shown in Chart 8B, the Government made significant progress in issuing long-term instruments during the fiscal year 2013/14. The 5-year Treasury bond accounted for the largest proportion of outstanding Government securities during the period, increasing from 13.7 percent in June 2013 to 14.4 percent in June 2014.

The trends in the holdings of Treasury bills and bonds by creditor categories are shown in Tables 8.2 and 8.3. Commercial banks reduced holdings of Treasury bills from 56 percent in June 2013 to 53.8 percent in June 2014 and raised holdings of Treasury bonds from 45.8 percent in June 2013 to 47.7 percent in June 2014.

TABLE 8.2: OUTSTANDING STOCK OF TREASURY BILLS BY HOLDER (KSH BN)

Holders	Jun-11		Jun-12		Jun-13		Jun-14	
	Ksh	%	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	119.4	75.9	105.5	65.2	212.3	64.8	204.7	62.5
Central Bank*	31.7	20.1	30.0	18.5	28.9	8.8	28.3	8.6
Comm. Banks	87.7	55.8	75.5	46.7	183.5	56.0	176.4	53.8
NBFI's	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance Companies	4.7	3.0	7.2	4.5	14.9	4.6	19.9	6.1
Parastatals	3.2	2.1	1.2	0.7	5.6	1.7	4.2	1.3
of which NSSF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Building Societies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	29.9	19.0	47.9	29.6	63.7	19.4	98.9	30.2
Total	157.3	100.0	161.8	100.0	296.6	90.5	327.7	100.0

* Includes Repo Treasury bills

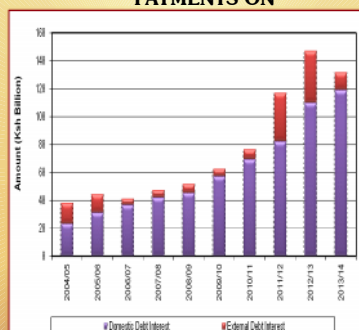
Source: Central Bank of Kenya

TABLE 8.3: OUTSTANDING STOCK OF TREASURY BONDS BY HOLDER (KSH BN)

Holders	Jun-11		Jun-12		Jun-13		Jun-14	
	Ksh	%	Ksh	%	Ksh	%	Ksh	%
Banking Institutions	290.9	48.8	338.9	49.3	341.2	45.9	436.4	47.7
Central Bank	0.0	0.0	3.3	0.5	0.0	0.0	0.0	0.0
Comm. Banks	288.4	48.4	334.1	48.6	341.0	45.8	436.3	47.7
NBFI's	2.5	0.4	1.5	0.2	0.2	0.0	0.2	0.0
Insurance Companies	74.7	12.5	74.7	10.9	93.7	12.6	101.2	11.1
Parastatals	23.7	4.0	21.6	3.1	42.7	5.7	34.4	3.8
of which NSSF	22.5	3.8	24.5	3.6	22.7	3.1	16.2	1.8
Building Societies	0.3	0.0	0.6	0.1	0.6	0.1	0.5	0.1
Others	206.1	34.6	251.1	36.6	266.0	35.7	342.1	37.4
Total	595.7	100.0	687.0	100.0	744.2	100.0	914.8	100.0

Source: Central Bank of Kenya

Debt Service

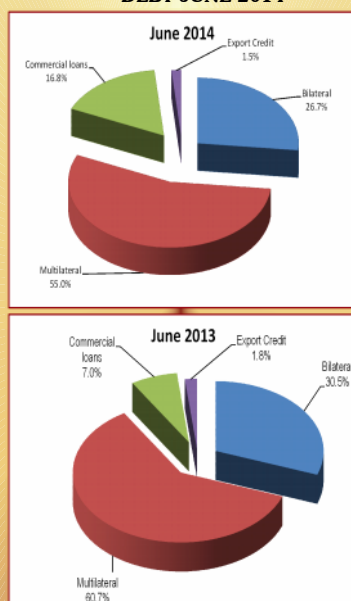
CHART 8C: INTEREST PAYMENTS ON

Sources: Central Bank of Kenya

As shown in Chart 8C, cumulative Government expenditure on interest and other charges on domestic debt increased from Ksh 110.2 billion in the fiscal year 2012/13 to Ksh 119 billion in the fiscal year 2013/14. However, interest accumulated on external debt decreased by Ksh 24.2 billion from Ksh 37 billion to Ksh 12.8 billion, during the FY 2013/14

Public and Publicly Guaranteed External Debt

Kenya's external debt increased by 28.7 percent from Ksh 843.6 billion in June 2013 to Ksh 1085.9 billion in June 2014 (Table 8.4) largely as a result of the issuance of the International Sovereign Bond and depreciation of the Kenya shilling against the Euro, dollar, Sterling Pound and other major world currencies.

CHART 8D: COMPOSITION OF EXTERNAL PUBLIC DEBT JUNE 2014

Sources: Central Bank of Kenya and National Treasury

TABLE 8.4: DISTRIBUTION OF EXTERNAL PUBLIC DEBT

	Jun-11	%	Jun-12	%	Jun-13	%	Jun-14	%
Bilateral	257.0	35.3	246.2	32.2	257.6	30.5	289.9	26.7
Multilateral	445.3	61.2	452.9	59.2	511.8	60.7	597.3	55.0
Commercial loans	0.0	0.0	50.5	6.6	58.9	7.0	182.2	16.8
Export Credit	25.0	3.4	14.8	1.9	15.2	1.8	16.5	1.5
Total	727.3	100.0	764.5	100.0	843.6	100.0	1085.9	100.0

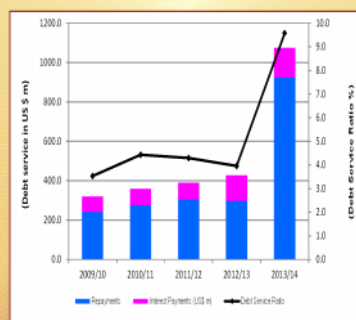
Sources: Central Bank of Kenya and National Treasury

The percentage of external debt owed to multilateral corporations (including loans from the IMF) declined from 60.7 percent in June 2013 to 55 percent in June 2014, the proportion of debt owed to bilateral creditors also decreased from 30.5 percent to 26.7 percent (Table 8.4 and Charts 8D). The proportion of external debt contracted through commercial loans increased marginally from 7 percent in June 2013 to 16.8 percent in June 2014.

The successful issuance of the International Sovereign bond largely contributed to the marginal increase in total external debt. The issue comprised of US\$ 500 million at an interest rate of 5.875 percent with a five year maturity and US\$ 1.5 billion at an interest rate of 6.875 percent with a maturity of 10 years. The amount on offer was US\$ 1.5 billion which received an over 500 percent subscription rate with total demand amounting to US\$ 8.8 billion. US\$ 600 million was used to retire the syndicated loan

External Debt Service

External debt service increased from Ksh 36.6 billion in June 2013 to Ksh 94.2 billion in June 2014. The external debt service during the period comprised Ksh 81 billion in principal repayments and Ksh 13.2 billion in interest payments. The debt service ratio, which is the ratio of external debt service payments to export earnings of goods and services, increased from 4.0 percent in the fiscal year 2012/13 to 9.6 percent in the fiscal year 2013/14. As shown in Chart 8E, the debt service ratio has generally been stable at an average of 4.0 percent since the fiscal year 2004/05 with marginal fluctuations in the FY 2013/14 where the debt service ratio rose to 9.6 percent.

**CHART 8E: EXTERNAL
DEBT SERVICE**

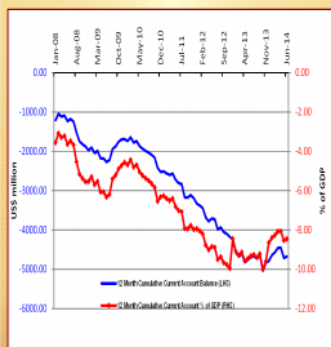
Sources: Central Bank of Kenya

Prospects for Fiscal Year 2014/15

Total public and publicly guaranteed external debt is estimated at Ksh1,195.7 billion (25.1percent of GDP), of which gross and net domestic debt stand at Ksh1,274.7 billion (26.8 percent of GDP) and Ksh 1,213.4 billion (25.5 percent of GDP), respectively.

9. BALANCE OF PAYMENTS

CHART 9A: TRENDS IN THE CURRENT ACCOUNT BALANCE



Sources: Central Bank of Kenya

Kenya's overall balance of payments position increased to a surplus of US\$ 2,397 million in the year to June 2014 from a surplus of US\$ 627 million in the year to June 2013. The increase was on account of expansion of the financial account reflecting increased inflows from the sale of the Eurobond in June 2014. The deficit in the current account recorded 0.4 percent improvement from US\$ 4,693 million (or 9.32 percent of GDP) in the year to June 2013 to US\$ 4,674 million (or 8.46 percent of GDP) in the year to June 2014 (Chart 9A and Table 9.1).

TABLE 9.1: BALANCE OF PAYMENTS (US \$ M)

ITEM	Year to June 2013*	Year to June 2014*				Year to June 2014*	Absolute Change	%
		Q1 Jul-Sep	Q2 Oct-Dec	Q3 Jan-Mar	Q4 Apr-Jun			
1. OVERALL BALANCE	627.41	209.28	174.08	101.42	1,912.20	2,396.97	1,769.56	282.04
2. CURRENT ACCOUNT	-4,692.61	-1,283.41	-1,323.62	-903.58	-1,163.89	-4,674.50	18.11	-0.39
2.1 Goods	-10,738.25	-2,848.46	-3,029.75	-2,440.44	-3,008.71	-11,327.36	-589.10	5.49
Exports (fob)	6,107.97	1,409.25	1,433.82	1,558.40	1,616.65	6,018.13	-89.84	-1.47
Coffee	217.62	50.77	39.04	44.23	71.78	205.82	-11.80	-5.42
Tea	1,290.99	295.59	265.36	278.47	261.97	1,101.39	-189.60	-14.69
Horticulture	731.82	163.71	201.38	215.37	205.16	785.63	53.81	7.35
Oil products	70.76	11.85	8.87	9.71	15.86	46.28	-24.48	-34.60
Manufactured Goods	684.80	183.93	170.24	165.66	144.07	663.91	-20.90	-3.05
Raw Materials	387.61	81.72	109.19	132.73	120.03	443.67	56.05	14.46
Chemicals and Related Products (n.e.s)	499.97	120.26	114.21	118.08	109.61	462.16	-37.81	-7.56
Miscellaneous Man. Articles	569.75	155.14	150.88	156.99	160.16	623.17	53.43	9.38
Re-exports	490.94	136.87	165.28	221.63	293.06	816.84	325.90	66.38
Other	1,163.71	209.40	209.37	215.54	234.96	869.27	-294.43	-25.30
Imports (cif)	16,846.22	4,257.71	4,463.58	3,998.84	4,625.36	17,345.49	499.27	2.96
Oil	3,954.38	837.62	1,011.84	943.85	1,159.11	3,952.42	-1.96	-0.05
Chemicals	2,148.50	570.31	596.35	580.18	566.47	2,313.30	164.81	7.67
Manufactured Goods	2,413.91	701.39	660.52	655.79	672.23	2,689.94	276.02	11.43
Machinery & Transport Equipment	4,866.68	1,200.53	1,174.38	1,088.86	1,412.45	4,876.23	9.55	0.20
Other	3,346.60	909.67	974.20	708.21	794.01	3,386.09	39.49	1.18
2.2 Services	6,045.65	1,565.05	1,706.14	1,536.86	1,844.82	6,652.86	607.21	10.04
Non-factor services (net)	3,494.87	848.88	931.86	1,038.61	1,130.22	3,949.57	454.70	13.01
Non-factor services credit	4,708.78	1,165.17	1,302.24	1,325.03	1,415.31	5,207.76	498.98	10.60
transportation	2,117.61	513.35	560.93	506.11	526.82	2,107.21	-10.40	-0.49
travel	899.81	215.82	205.89	186.96	200.80	809.47	-90.34	-10.04
Other services account: gov't	930.60	255.40	211.36	227.58	235.62	929.95	-0.65	-0.07
Other services account: private	760.77	180.61	324.06	404.38	452.07	1,361.12	600.36	78.91
Income (net)	-265.26	-81.41	-73.27	-38.30	-102.64	-295.62	-30.36	11.44
of which official interest	-132.84	-33.36	-24.50	-23.25	-77.68	-158.80	-25.95	19.53
Current Transfers	2,816.04	797.58	847.55	536.55	817.24	2,998.91	182.87	6.49
Private (net)	2,608.02	748.67	798.64	541.37	822.06	2,910.74	302.72	11.61
of which remittances	1,198.55	327.33	339.55	340.99	348.47	1,356.35	157.80	13.17
Public (net)	208.03	48.91	48.91	-4.82	-4.82	88.17	-119.85	-57.61
3. CAPITAL & FINANCIAL ACCOUNT	5,320.02	1,492.69	1,497.69	1,004.99	3,076.09	7,071.47	1,751.45	32.92
3.1 Capital Transfers (net)	146.11	10.66	27.81	29.90	134.47	202.84	56.74	38.83
3.2 Financial Account	5,173.91	1,482.03	1,469.88	975.10	2,941.62	6,868.63	1,694.71	32.75
Official, medium & long-term	683.16	12.32	71.21	198.49	1,671.22	1,953.23	1,270.07	185.91
Inflows	990.49	111.79	162.05	296.01	2,333.12	2,902.97	1,912.48	193.08
Outflows	-307.33	-99.47	-90.84	-97.52	-661.90	-949.74	-642.41	209.03
Private, medium & long-term (net)	304.98	-19.79	-184.05	298.19	-4.30	90.05	-214.93	-70.47
Commercial Banks (net)	367.41	9.69	6.02	301.67	143.37	460.74	93.33	25.40
Other private medium & long-term (net)	-62.43	-29.48	-190.07	-3.48	-147.66	-370.69	-308.26	493.79
Short-term (net) incl. errors & omissions	4,185.77	1,489.51	1,582.72	478.42	1,274.70	4,825.34	639.57	15.28
Memo:								
Gross Reserves	7,888.94	7,958.83	8,483.20	8,279.04	10,398.74	10,398.74	2,509.79	31.81
Official	6,089.00	6,290.71	6,560.17	6,653.92	8,554.53	8,554.53	2,465.53	40.49
imports cover**	4.05	4.17	4.30	4.42	5.52			36.39
imports cover***	4.35	4.39	4.49	4.52	5.70			31.07
Commercial Banks	1,799.94	1,668.11	1,923.02	1,625.12	1,844.21	1,844.21	44.26	2.46

* Provisional

** Based on current year's imports of goods and non-factor services

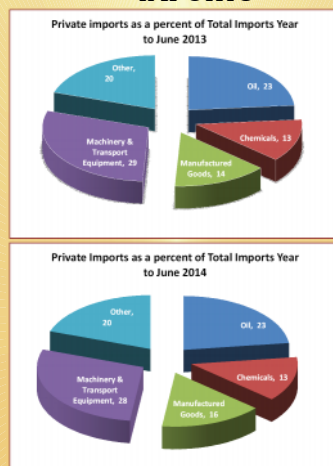
*** Based on 36 months average of imports of goods and non-factor services

Source: Central Bank of Kenya

Goods Account

Kenya's trade deficit worsened by US\$ 589.1 million to US\$ 11,327 million in the year to June 2014 from US\$ 10,738 million in the year to June 2013. The 5.5 percent deterioration in the trade account was attributed to increased payments for merchandise imports combined with decreased earnings from merchandise exports (Table 9.1).

CHART 9B: COMPOSITION OF KENYA'S IMPORTS



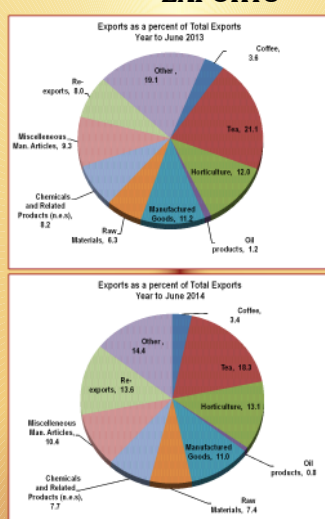
Source: Central Bank of Kenya

Imports

The import bill rose to US\$ 17,345 million in the year to June 2014 from US\$ 16,846 million in the year to June 2013, reflecting increased payments for chemicals; manufactured goods; machinery and transport equipment. The increase in imports of machinery and transport equipment was on account of increased imports of machinery specialised for particular industries; general industrial machinery; telecommunications machinery and road vehicles.

Payments for oil imports declined from US\$ 3,954 million in the year to June 2013 to US\$ 3,952 million in the year to June 2014 on account of reduced imports of crude petroleum oils.

CHART 9C: COMPOSITION OF KENYA'S EXPORTS



Source: Central Bank of Kenya

Exports

Earnings from merchandise exports declined by 1.5 percent to US\$ 6,018 million in the year to June 2014 from US\$ 6,108 million in the year to June 2013. Reduced earnings from coffee, tea, oil products, manufactured goods; chemicals and related products and other exports contributed to this decline. Earnings from coffee exports decreased by 5.4 percent to US\$ 206 million in the year to June 2014 reflecting a reduction in export quantities while those from tea exports declined by 14.7 percent to USD 1,101 million in the year to June 2014, largely on account of a decline in international prices. Receipts from exports of horticulture, raw materials, miscellaneous manufactured articles and re-exports increased during the review period.

Services Account

Trade in international services recorded a surplus of US\$ 6,653 million in the year to June 2014 from a surplus of US\$ 6,046 million (10 percent increase). This was mainly on account of increased flows from non-factor services. The increase in non-fac-

tor service flows was largely driven by inflows from other private services (insurance and communication services). The surplus in the current transfers account improved by 6.5 percent in the year to June 2014 to US\$ 2,999 million largely attributed to increased remittances from the Diaspora which increased by 13.2 percent to US\$ 1,356 million during the year to June 2014 from US\$ 1,199 million during the year to June 2013. Remittance transfers have remained resilient. (Table 9.2).

TABLE 9.2: REMITTANCES TO KENYA ('000 US \$)

Month/Year	2007	2008	2009	2010	2011	2012	2013	2014
January	40,930	53,925	39,535	45,117	64,139	89,755	102,969	110,969
February	39,533	50,382	53,353	46,423	60,759	103,970	102,372	110,421
March	48,562	59,344	55,361	52,309	71,557	106,198	103,393	119,585
April	38,251	67,872	48,117	52,679	70,071	95,625	104,993	113,409
May	41,163	48,538	49,180	51,172	68,124	100,995	110,150	119,657
June	48,643	49,490	46,347	52,541	71,888	99,488	99,809	116,064
July	53,350	44,137	50,372	50,652	72,797	92,736	112,834	
August	58,803	43,388	55,947	51,993	79,563	94,819	107,049	
September	60,575	48,953	53,347	58,557	84,854	92,519	107,452	
October	46,848	61,113	53,037	58,503	81,311	91,627	112,919	
November	55,564	43,970	48,058	56,380	80,802	97,504	113,420	
December	41,421	40,129	56,329	65,617	85,244	105,656	113,216	
Annual Total	573,643	611,241	608,983	641,943	891,109	1,170,893	1,290,575	690,105

Source: Central Bank of Kenya

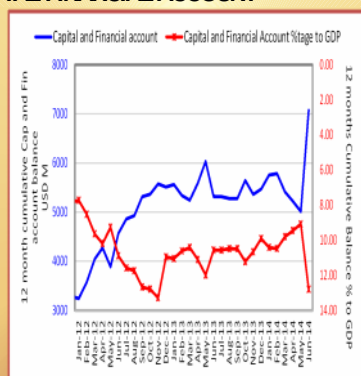
Capital and Financial Flows

The surplus in the capital and financial account improved to US\$ 7,071 million (or 12.8 percent of GDP) in the year to June 2014 from US\$ 5,320 million (or 10.6 percent of GDP) in the year to June 2013 (Chart 9D) largely attributed to 32.8 percent growth in the financial account surplus attributed to increased official flows reflecting proceeds from the sale of the Eurobond in June 2014. Commercial bank flows increased to US\$ 461 million in the year to June 2014 from US\$ 367 million in the year to June 2013 after commercial banks run down their net foreign assets. Short term flows (including net errors and omissions) increased by 15.3 percent during the period under review.

Direction of Trade

Table 9.3 shows that the share of Kenya's exports to Africa dropped to 45.3 percent in the year to June 2014 from 46.8 percent in the year to June 2013. The decline was in the value of exports to Uganda, Tanzania, Egypt, South Sudan, Somalia, the Democratic Republic of Congo, Rwanda, the United Kingdom, Pakistan, the United Arab Emirates and Afghanistan while

CHART 9D: TREND IN THE CAPITAL FINANCIAL ACCOUNT



Source: Central Bank of Kenya

exports to Sudan, the Netherlands, the USA, Germany and India increased.

TABLE 9.3: KENYA'S EXPORTS: MAIN DESTINATION COUNTRIES (US\$ M)

Destination Country	Exports (US\$ millions)			Share of Exports (%)		
	Fiscal Years			Fiscal Years		
	2011/12	2012/13	2013/14	2011/12	2012/13	2013/14
Uganda	814	792	719	13.6	13.0	11.9
Tanzania	521	506	499	8.7	8.3	8.3
Egypt	269	235	198	4.5	3.8	3.3
Sudan	167	68	73	2.8	1.1	1.2
South Sudan	74	216	193	1.2	3.5	3.2
Somalia	233	211	171	3.9	3.4	2.8
DRC	209	227	221	3.5	3.7	3.7
Rwanda	166	184	166	2.8	3.0	2.8
Others	435	423	485	7.3	6.9	8.1
Total Africa	2,888	2,860	2,724	48.4	46.8	45.3
United Kingdom	487	478	425	8.2	7.8	7.1
Netherlands	361	373	439	6.1	6.1	7.3
USA	298	331	395	5.0	5.4	6.6
Pakistan	249	286	242	4.2	4.7	4.0
United Arab Emirates	248	364	262	4.2	6.0	4.4
Germany	104	105	115	1.7	1.7	1.9
India	105	99	108	1.8	1.6	1.8
Afghanistan	135	173	141	2.3	2.8	2.3
Others	3,922	3,890	3,906	65.8	63.7	64.9
Total Exports	5,962	6,108	6,018	100	100	100

Source: Central Bank of Kenya

In the year to June 2014, Kenya sourced most of its imports from India (18.3 percent), China (13.6 percent), the United Arab Emirates (6.1 percent) and Japan (5.8 percent). Imports from Africa accounted for 9.9 percent of total imports and increased to US\$ 1,715 million in the year to June 2014. The increase was reflected in increased imports from South Africa and other African countries. Imports from India, China, Japan, the USA, Germany, the Netherlands and Bahrain also increased.

TABLE 9.4: KENYA'S IMPORTS: MAIN SOURCE COUNTRIES (US\$ M)

Source Country	Imports (US\$ millions)			Share of Imports (%)		
	Fiscal Years			Fiscal Years		
	2011/12	2012/13	2013/14	2011/12	2012/13	2013/14
South Africa	768	724	834	4.8	4.3	4.8
Egypt	273	335	282	1.7	2.0	1.6
Others	1,456	1,299	1,433	9.1	7.7	8.3
Total Africa	1,728	1,635	1,715	10.8	9.7	9.9
India	1,802	2,576	3,178	11.3	15.3	18.3
United Arab Emirates	2,142	1,688	1,052	13.4	10.0	6.1
China	1,811	1,935	2,355	11.4	11.5	13.6
Japan	697	860	1,002	4.4	5.1	5.8
USA	671	730	915	4.2	4.3	5.3
United Kingdom	508	571	544	3.2	3.4	3.1
Singapore	110	231	205	0.7	1.4	1.2
Germany	431	457	514	2.7	2.7	3.0
Saudi Arabia	888	557	479	5.6	3.3	2.8
Indonesia	669	530	554	4.2	3.1	3.2
Netherlands	216	226	274	1.4	1.3	1.6
France	260	284	243	1.6	1.7	1.4
Bahrain	227	449	496	1.4	2.7	2.9
Italy	196	245	232	1.2	1.5	1.3
Others	5,098	4,962	4,940	31.9	29.5	28.5
Total Imports	15,959	16,846	17,345	100	100	100

Source: Central Bank of Kenya

Kenya's Trade Structure

In 2013, Kenya's trade with Europe accounted for 20.6 per cent of the total and was valued at Ksh 1,915.6 billion. The bulk of trade was conducted with countries within the European Union (Table 9.5).

Kenya's share to total trade with Africa declined to 19.8 per cent in 2103 from 20.7 percent in 2012. Trade with COMESA countries (excluding Uganda, Rwanda and Burundi) declined to Ksh 221.9 billion in 2013 from Ksh 237.3 billion in 2012, while trade with the East African Community also decreased marginally from Ksh 165.8 billion in 2012 to Ksh 153.8 billion in 2013. Within the EAC region, trade with Tanzania and Uganda declined to Ksh 52.2 billion and Ksh 81.4 billion respectively in 2013 from Ksh 60.4 billion and Ksh 82.8 billion respectively in 2012.

The Asian region was Kenya's dominant trading partner accounting for 52.4 percent of total trade in 2013 up from 50.8 percent in 2012. Trade between Kenya and the Far East countries (including China, India, Indonesia, Japan, South Korea, Pakistan, Singapore among others) increased from Ksh 635.8 billion in 2012 to Ksh 744.9 billion in 2013. Trade with the Middle East countries (Iran, Israel, Jordan, Saudi Arabia and United Arab Emirates among others) however, declined to Ksh 259.4 billion in 2013 from US\$ 326.2 billion in 2012 largely reflecting substantial reduction of imports from Iran, Jordan, Saudi Arabia and the United Arab Emirates. The reduction of imports from the United Arab Emirates was on account of reduced importation of crude oil.

TABLE 9.5: KENYA'S TRADE STRUCTURE

	Total Trade, KSH Billion				% share to total trade			
	2010	2011	2012	2013*	2010	2011	2012	2013*
Europe	313.3	391.2	375.0	393.9	23.1	21.6	19.8	20.6
Western Europe	287.1	354.0	340.0	343.2	21.2	19.5	18.0	17.9
European Union	264.6	309.4	312.9	312.3	19.5	17.1	16.5	16.3
Others	18.7	39.0	25.9	28.4	1.4	2.1	1.4	1.5
Eastern Europe	26.2	37.2	35.0	50.7	1.9	2.1	1.8	2.6
America	80.0	106.8	148.0	118.2	5.9	5.9	7.8	6.2
U.S.A	61.8	70.3	92.4	87.3	4.6	3.9	4.9	4.6
Others	18.2	36.4	55.7	30.9	1.3	2.0	2.9	1.6
Africa	303.7	398.9	391.3	379.3	22.4	22.0	20.7	19.8
E.A.Community	121.7	164.1	165.8	153.8	9.0	9.0	8.8	8.0
Tanzania	43.8	57.4	60.4	52.2	3.2	3.2	3.2	2.7
Uganda	61.3	86.3	82.8	81.4	4.5	4.8	4.4	4.3
Comesa ^a	176.8	236.8	237.3	221.9	13.0	13.1	12.5	11.6
Other Countries	83.1	104.6	93.6	105.2	6.1	5.8	4.9	5.5
Asia	649.5	904.7	962.0	1004.3	47.9	49.9	50.8	52.4
Middle East	199.3	332.6	326.2	259.4	14.7	18.3	17.2	13.5
Far East	450.3	572.2	635.8	744.9	33.2	31.6	33.6	38.9
Australia & Oceania	4.7	4.0	10.0	15.9	0.3	0.2	0.5	0.8
All other Countries N.E.S	5.7	7.7	6.1	4.0	0.4	0.4	0.3	0.2
Grand Total	1357.0	1813.3	1892.4	1915.6	100.0	100.0	100.0	100.0

*Provisional

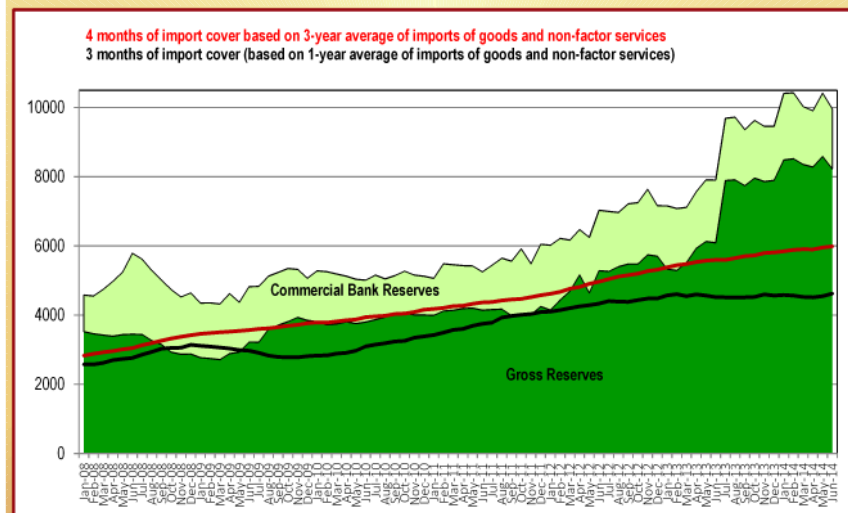
^a Excluding member countries Uganda, Rwanda & Burundi

Source: Economic Survey, 2014

Foreign Exchange Reserves

The banking system's total foreign exchange holdings increased by 31.8 percent from US\$ 7,889 million in June 2013 to US\$ 10,399 million in June 2014. Official reserves held by the Central Bank constituted the bulk of gross reserves and increased by 40.5 percent to US\$ 8,555 million or 5.7 months of import cover in June 2014. The accumulation of official reserves during the period consisted of receipts from the sale of the Eurobond in June 2014, IMF disbursements under the Extended Credit Facility programme financing and Central Bank's activities in the Foreign Exchange market. Total official reserves have remained above the statutory requirement of minimum months of import cover. Foreign Exchange Reserves held by Commercial Banks increased marginally by US\$ 44.3 million or 2.5 percent to US\$ 1,844 million in June 2014.

CHART 9E: FOREIGN EXCHANGE RESERVES



Source: Central Bank of Kenya

FINANCIAL SECTOR DEVELOPMENTS

10. BANKING SECTOR DEVELOPMENTS

Overview

The Kenyan banking sector comprised 43 commercial banks, 1 mortgage finance company, 9 microfinance banks, 8 representative offices of foreign banks, 5 money remittance providers, 97 foreign exchange bureaus and 2 credit reference bureaus during the period ended June 30, 2014. The Banking Sector registered improved performance (Table 1):

- Assets increased to Ksh 3.0 trillion as at June 30, 2014 from Ksh 2.5 trillion in June 30, 2013.
- Loans and advances grew to Ksh 1.8 trillion in June 30, 2014 compared to Ksh 1.5 trillion as at June 30, 2013.
- The deposit base expanded to Ksh 2.1 trillion in June 30, 2014 an increase from Ksh 1.9 trillion reported in June 30, 2013.
- Profit before tax for the period ended June 30, 2014 was Ksh 71.0 billion compared to Ksh 61.5 billion reported in the period ended June 30, 2013.

Structure of the Balance Sheet

The banking sector balance sheet expanded by 18 percent from Ksh 2.5 trillion in June 2013 to Ksh 3.0 trillion in June 2014. The main components of the balance sheet on the asset side were loans and advances, government securities and placements, which accounted for 58.0 percent, 21.3 percent and 5.1 percent of total assets, respectively. Customer deposits were the main component on the liabilities side accounting for 72.3 percent of the total liabilities.

TABLE 10.1: BALANCE SHEET (KSH MILLION)

	Jun-13	Jun-14	% Change
Cash	43,779	50,814	16%
Balances at CBK	124,815	123,260	-1%
Placements	156,718	151,419	-3%
Government Securities	562,992	633,291	12%
Other Investments	55,847	61,445	10%
Loans & Advances (Net)	1,400,052	1,720,254	23%
Other Assets	169,302	227,139	34%
Total Assets	2,513,505	2,967,622	18%
Deposits	1,857,342	2,147,933	16%
Other Liabilities	261,775	360,303	38%
Capital & Reserves	394,388	459,386	16%

Source: Central Bank of Kenya

Loans and Advances

The banking sector gross loans and advances rose from Ksh 1.5 trillion in June 2013 to Ksh 1.8 trillion in June 2014 translating to a growth of 22.6 percent. The growth in loans and advances was recorded in all the 11 sectors as indicated in Table 10.2.

TABLE 10.2: SECTORAL DISTRIBUTION OF LOANS (KSH BN)

Sectors	Jun-13	Jun-14	% Change
Personal/Household	376.9	442.9	17.50%
Trade	300.4	365.5	21.70%
Manufacturing	193.1	224.2	16.10%
Real Estate	194.9	257.5	32.10%
Transport and Communication	99.4	132.7	33.50%
Agriculture	67	72.6	8.40%
Financial Services	53.2	68.3	28.40%
Building and Construction	71.7	82.7	15.30%
Energy and Water	49.6	78.4	58.10%
Tourism, Restaurant and Hotels	34.4	41.5	20.60%
Mining and Quarrying	14.3	17.9	25.20%
Gross/Total	1,454.90	1,784.20	22.60%

Source: Central Bank of Kenya

Deposit Liabilities

Customer deposits were the main source of funding for the banking sector assets, accounting for 72.3 percent of total liabilities. The deposit base increased by 16.5 percent from Ksh 1.9 trillion in June 2013 to Ksh. 2.1 trillion in June 2014 mainly attributed to branch expansion, remittances, receipts from exports and agency banking. The deposit accounts increased by 33.9 per cent from 18.9 million accounts in June 2013 to 25.3 million in June 2014.

Capital and Reserves

The banking sector registered improved capital levels in the period ended June 2014 with total capital, which comprises core and supplementary capital, growing by 19.9 percent from Ksh 364.0 billion in June 2013 to Ksh 436.6 billion. The shareholders' funds increased by 16.5 percent from Ksh 394.4 billion in June 2013 to Ksh 459.4 billion in June 2014. However, the ratios of total and core capital to total risk-weighted assets decreased from 23.3 percent and 20.2 percent in June 2013 to 17.5 percent and 15.0 percent in June 2014 respectively.

The decline in capital adequacy ratios is due to higher increase in total risk weighted assets than the increase in the capital base. This is because with effect from January 2014, banks are required to hold capital charge for market and operational risks which in effect increases their risk weighted assets base.

Non-Performing Loans

The gross non-performing loans (NPLs) increased by 31.6 percent from Ksh 77.3 billion in June 2013 to Ksh 101.7 billion in June 2014. Similarly, the ratio of gross NPLs to gross loans increased from 5.3 percent in June 2013 to 5.7 percent in June 2014.

The spill-over effects of high lending interest rates in 2012 and challenges in the business environment contributed to the increase in NPLs. However, banks continue to deploy enhanced appraisal standards to mitigate credit risk.

During the period under review, 10 out of 11 economic sectors registered increase in NPLs as shown in Table 10.3.

TABLE 10.3: SECTORAL DISTRIBUTION OF NPLs (KSH BN)

Sectors	Jun-13	Jun-14	% Change
Personal/Household	21.9	23.9	9.10%
Trade	20	26.9	34.50%
Manufacturing	4.9	10.8	120.40%
Real Estate	10.8	12.1	12.00%
Transport and Communication	6.1	7.4	21.30%
Agriculture	5	5.2	4.00%
Financial Services	1.5	1.6	6.70%
Building and Construction	4.2	9.4	123.80%
Energy and Water	1.1	1.1	0.00%
Tourism, Restaurant and Hotels	1.7	2.6	52.90%
Mining and Quarrying	0.1	0.6	500.00%
Gross NPLs	77.3	101.7	31.60%

Source: Central Bank of Kenya

Profitability

The banking sector registered Ksh 71.0 billion pre-tax profits during the period ending June 30, 2014, which was an increase of 15.4 percent from Ksh 61.5 billion for the period ending June 2013. Total income for the period stood at Ksh 199.0 billion, a growth of 12.2 percent compared with Ksh 177.3 billion registered at the end of June 2013. However, total expenses increased by 10.4 percent from Ksh 115.9 billion in June 2013 to Ksh. 128.0 billion in June 2014.

Interest on loans and advances of Ksh 116.4 billion constituted 59 percent of total income in the period ended June 2014. On the other hand, interest on deposits, staff costs and other expenses were the key components of expenses, account-

TABLE 10.4: BANKING INDUSTRY PROFITS (KSH BILLION)

Item	Jun-13	Jun-14	% Change
Total income	177.3	199	12.20%
Expenses before provisions	121.4	133.3	9.80%
Profit before provisions	67	76.3	13.90%
Provisions for bad debts	5.5	5.3	-3.60%
Profit before tax	61.5	71	15.40%

Source: Central Bank of Kenya

ing for 33 percent, 28 percent and 24 percent of total expenses, respectively.

11. OTHER BANKING SECTOR DEVELOPMENTS

Credit Information Sharing Mechanism

The Credit Information Sharing (CIS) mechanism has continued to register increased usage by the banks since its launch in July 2010. The cumulative number of credit reports requested by banks stood at 4,325,200 in June 2014 an increase of 48.8 percent compared with 2,907,375 reports in June 2013.

Banks have now incorporated credit reference reports in their credit risk appraisal processes. It is expected that borrowers with good track record will be able to negotiate for competitive credit terms including accessing credit based on their credit history without a requirement for collateral.

Agency Banking

The use of the agency banking model by banks has continued to improve access to banking services since its launch in 2010. As at June 30, 2014, CBK had authorized 15 commercial banks to offer banking services through third parties (agents). Since 2010, a total of 26,750 agents had been contracted by the banks. These agents had undertaken over 106.1 million transactions valued at Ksh 571.5 billion. As at June 2013, 13 banks had contracted 19,649 active agents who had facilitated over 58.6 million transactions valued at Ksh 310.5 billion.

Microfinance Banks

The Microfinance (Amendment) Act, 2013 which was assented to by His Excellency the President on 27th November 2013 introduced a number of changes such as the deposit taking microfinance (DTMs) institutions to be referred to as Microfinance Banks (MFBs). In addition, the MFBs are to share both negative and positive credit information with commercial banks through credit reference bureaus. However, even though they are called “banks”, they will still operate under the Microfinance Act and will not be affected by the Banking Act under which commercial banks are licensed.

The number of Microfinance Banks (MFBs) in operation remained at 9 in June 2014. MFBs had granted gross loans worth Ksh 32.9 billion June 30, 2014, compared to Ksh 22.5 billion registered in June 2013 thus translating to a growth of 46.2 percent. The de-

posits base stood at Ksh 30.7 billion representing a growth of 55.8 percent from Ksh 19.7 billion in June 2013. The number of MFBs deposit accounts stood at 2.1 million in June 2014 compared to 1.9 million deposit accounts at end of June 2013.

Representative Offices

The Central Bank granted authority to Rabobank Nederland to open a Representative Office in Kenya in June 2014,. This brought the number of foreign banks that operate Representative Offices in Kenya to 8.

Under the Banking Act, a Representative Office of a foreign bank in Kenya is not permitted to engage in banking business as defined in the Act but can only engage in marketing and liaison roles in connection with the activities of its parent bank and affiliates.

Money Remittance Providers

The Central Bank of Kenya Act was amended in 2012 by expanding the definition of authorized dealers to include Money Remittance Providers. This amendment facilitated the formulation of the Money Remittance Regulations which were gazetted in April 2013. Some of the factors that necessitated the creation of this framework were:

- √ the need to reduce barriers and lower the cost of sending and receiving money and increase transparency;
- √ to foster competition, enhance innovations and increase access to money remittance products and services to the low income group; and
- √ to create an enabling environment to increase the flows of remittances through formal financial delivery channels.

The licensed Money Remittance Providers were 5 as at June 30, 2014.

Banking sector 2014 Outlook

The banking sector is expected to maintain its growth momentum mainly driven by the rollout of full file credit information sharing, regional in-tegration initiatives, advances in information and communication tech-nology and the introduction of the devolved governance system in Kenya.

MODES OF PAYMENTS

There are two main modes of payments, namely non-cash and cash instruments.

1 NON-CASH INSTRUMENTS

1.1 KENYA ELECTRONIC PAYMENT AND SETTLEMENT SYSTEM (KEPSS)

Kenya Electronic Payments and Settlement System (KEPSS) moved a volume of 2,230,049 transactions worth Ksh 24,311 billion in the year to June 30, 2014, compared to 1,757,482 transactions worth Ksh 20,686 billion in the same period last year. The growth represents a 26.9 percent and 17.5 percent increase in volume and value respectively. The average amount moved per transaction decreased from Ksh11.81 million to Ksh 10.94 million, reflecting a decrease of 7.4 percent signifying increased use of the system by the public for low value payments. The number of transactions moved per day, however, increased by 27.8 percent to 8,954 transactions from 7,006 transactions in the year to June 30, 2014. This increase is attributed to growing awareness by the public of KEPSS as a safe and efficient mode of payment for both high value and time critical payments and the continuing effects of both value capping and G-Pay system that combined to increase the daily flows through the KEPSS System. The proportion of direct payments through KEPSS increased from 98.4 percent to 98.5 percent, while Clearing House Net Settlement Instructions (NSI) proportion processed through KEPSS decreased from 1.6 percent 1.5 percent to in the same period (Tables 12.1 and 12.2).

TABLE 12.1: TRENDS IN TOTAL ANNUAL FLOWS

Year to June 30	Total value moved per year (Ksh m)	No. of Transactions	Average value per transaction (Ksh m)	Days worked	Per day	
					Value (Ksh m)	Transactions
2008	14,506,951	232,516	62.30	247	59,419	949
2009	15,441,446	277,445	55.67	248	62,139	1,121
2010	16,806,252	673,368	28.78	254	66,259	2,663
2011	18,792,538	1,048,206	17.81	252	74,758	4,163
2012	20,886,830	1,406,886	14.98	252	82,884	5,583
2014	20,686,221	1,757,482	11.81	252	84,417	7,006
2014	24,311,160	2,230,049	10.94	250	97,443	8,954

Source: Central Bank of Kenya, Banking/National Payments Division

TABLE 12.2: DIRECT PAYMENT VS. NET SETTLEMENT INSTRUCTIONS (NSI)

Year to June 30	Total value moved (Ksh)	Settlement proportions		Indirect {NSI (Ksh m)}	%
		Direct (Ksh m)	%		
2008	14,506,951	13,606,759	93.79	900,193	6.21
2009	15,441,446	14,549,876	94.23	891,570	5.77
2010	16,806,252	14,549,876	86.57	2,256,376	13.43
2011	18,792,538	16,360,759	87.06	2,431,779	12.94
2012	20,866,830	20,549,173	98.48	317,657	1.52
2013	20,686,221	20,355,986	98.40	330,235	1.60
2014	24,311,160	23,956,098	98.54	355,061	1.46

Source: Central Bank of Kenya, Banking/National Payments Division

MT 102 (a single customer transfer message that credits multiple beneficiaries) and MT 103 (a single customer transfer message that credits one beneficiary) are messages processed by commercial banks through KEPSS on behalf of their customers.

Multiple third parties Message Type MT 102 increased by 9.79 percent from 164,545 messages in the year to June 30, 2013 to 180,654 messages in the year to June 30, 2014. In the same period, single third party Message Type MT 103 increased by 28.52 percent from 1,850,580 messages to 2,378,351 messages. Overall, total third party messages processed through KEPSS increased by 26.99 percent from 2,015,125 messages to 2,559,005 messages in the year to June 30, 2014 (Table 12.3). The increase in these messages reflects growing awareness of KEPSS among the public as a safe and efficient payment system for large value and time critical payment systems.

TABLE 12.3: THIRD PARTY TRANSACTIONS PROCESSED THROUGH KEPSS BY MESSAGE TYPE

Year to June 30	MT102	MT103	TOTAL
2008	9,132	75,674	84,806
2009	9,410	115,443	124,853
2010	73,704	561,768	635,472
2011	125,262	977,569	1,102,831
2012	151,814	1,395,902	1,547,716
2013	164,545	1,850,580	2,015,125
2014	180,654	2,378,351	2,559,005

Source: Central Bank of Kenya, Banking/National Payments Division

1.2 THE AUTOMATED CLEARING HOUSE OPERATIONS

Automated Clearing House (ACH) operated smoothly during the year to June 30, 2014. The ACH throughput for the period under review was 29.55 million transactions with a value of Ksh2,890 billion for both Debit and Credit instruments compared to 27.82 million transactions valued at Ksh2,607 billion in the same period last year as indicated in Table 12.4. This represents an increase of 10.8 percent and a 6.2 percent in value volume, respectively. This outcome can be attributed to the reduced clearing cycle after implementation of cheque truncation and the trust the public has in the new clearing system. Cheques dominated the ACH payment instruments accounting for 65.05 percent of total volume of transactions through the Clearing House. In the year to June 2014, the volume of cheques processed through the Automated Clearing House was 19.2 million cheques valued at Ksh 2,419 billion compared to 18.4 million cheques valued at Ksh 2,196 billion in similar period in 2013.

Electronic Funds Transfer (EFT) transactions based payments increased by 14.51 percent during this period from Ksh 411 billion to Ksh 471 billion (Table 12.4).

TABLE 12.4: CLEARING HOUSE KSH TRANSACTIONS TO JUNE 30, 2014

Financial Year	Items	Values (Ksh bn)	Volumes ('000')
2008	Debit	3,616	18,670
	Credit	676	5,496
	Total	4,293	24,166
2009	Debit	3,901	18,549
	Credit	766	7,859
	Total	4,667	26,408
2010	Debit	1,954	15,732
	Credit	367	9,304
	Total	2,321	25,036
2011	Debit	1,939	16,713
	Credit	345	11,942
	Total	2,284	28,655
2012	Debit	2,134	18,222
	Credit	363	9,409
	Total	2,497	27,631
2013	Debit	2,196	18,436
	Credit	411	9,386
	Total	2,607	27,821
2014	Debit	2,419	19,221
	Credit	471	10,328
	Total	2,890	29,548

Source: Central Bank of Kenya, Banking/National Payments Division

The ACH recorded mixed performance in Domestic Foreign Currency Cheque Clearing (DFCCC) in the year to June 30, 2014 compared to the same period last year. The US dollar denominated Cheques processed through the clearing house increased by 1.55 percent margin from a volume of 402.4 to 408.6 thousand. The GBP and EURO denominated Cheques processed through the clearing house decreased from a volume of 1.9 and 11.2 thousand to 1.7 and 10.2 thousand respectively. This represents a decrease of 7.55 percent and 9.06 percent respectively. In terms of value moved, the US dollar and the EURO recorded a decrease of 8.26 percent and 14.50 percent respectively while the GBP recorded an increase of 18.30 percent (Table 12.5). The US dollar dominated the domestic foreign currency cheque clearing followed by the Euro and the Pound, respectively.

TABLE 12.5: DOMESTIC FOREIGN CURRENCY CHEQUE CLEARING TRANSACTIONS TO JUNE 30, 2014

Currency As at June	USD		GBP		EURO	
	Value (m)	Volume (‘000’)	Value (m)	Volume (‘000’)	Value (m)	Volume (‘000’)
2008	2,457.48	278.0	35.82	2.68	99.06	7.9
2009	2,637.32	282.0	52.98	2.95	138.31	9.8
2010	1,500.33	302.4	17.57	2.57	75.75	10.0
2011	1,239.25	337.2	11.41	2.29	77.01	12.3
2012	1,475.46	393.9	6.43	1.97	57.02	11.0
2013	1,566.31	402.4	5.86	1.88	47.35	11.2
2014	1,436.98	408.6	6.93	1.74	40.48	10.2
Growth (%)	-8.26%	1.55%	18.30%	-7.55%	-14.50%	-9.06%

Source: Central Bank of Kenya, Banking Services Division

1.3 AUTOMATED TELLER MACHINES (ATMS) AND PLASTIC CARD USAGE

The number of Automated Teller Machines (ATMs) in the payment card industry increased by 7.3 percent from 2,439 ATMs in June 2013 to 2,618 ATMs in June 2014. This growth may be attributed to commercial banks' business expansion strategies.

The value of transactions effected through cards in the year to June 2014 increased by 9.58 percent from Ksh 716.44 billion to Ksh 785.09 billion for acquirers while the issuers recorded a marginal decrease of 1.63 percent from Ksh 1365.43 billion to Ksh 1343.17 billion. Correspondingly, the number of transactions decreased by 23.14 percent and 0.79 percent from 291.22 million withdrawals to 223.83 million withdrawals and 311.83 million withdrawals to 309.38 million withdrawals for acquirers and issuers, respectively. The mixed performance can be attributed to the challenges commercial banks experienced during the migration to EMV standards in the industry. The grow-

ing usage of cards signifies a growing shift from cash based payments to non-cash payments by the public (Table 12.6A). The total number of cards in use rose by 16.5 percent from 10.9 million cards in June 2013 to 12.7 million cards in June

TABLE 12.6A: AUTOMATED TELLER MACHINES USAGE

	2008	2009	2010	2011	2012	2013	2014
Number of ATM machines	1,510	1,827	1,943	2,183	2,292	2,439	2,618
Number of transactions (m)							
Acquirers	77.92	86.72	93.43	110.56	148.8	291.22	223.83
Issuers	54.7	77.42	83.8	115.7	219.98	311.83	309.38
Other	3.44	3.56	-	-	0.01	0.29	0.27
Value of transactions (bn)							
Acquirers	396.93	431.79	507.99	623.74	673.34	716.44	785.09
Issuers	258.33	417.04	439.22	555.17	762.23	1365.43	1343.17
Other	18.51	18.93	23.39	29.91	62.52	73.37	77.44

Source: NPS Cards Statistics

2014, with debit cards recording a growth of 27.47 percent from 9.1 million cards in June 2013 to 11.6 million cards in June 2014 (Table 12.6B).

1.4 MOBILE PHONE USAGE FOR FUNDS TRANSFER

TABLE 12.6B: NUMBER OF CARDS IN CIRCULATION

	2008	2009	2010	2011	2012	2013	2014
ATM cards	900,148	985,141	1,252,893	1,439,729	1,640,004	1,625,895	906,908
Debit cards	1,528,866	3,700,646	4,156,187	7,002,091	8,121,460	9,126,946	11,588,007
Credit cards	107,653	106,842	111,383	117,835	131,397	133,137	187,765
Charge cards	5,160	1,682	791	1,418	2,877	772	652
Total	2,541,827	4,794,311	5,521,254	8,561,073	9,895,738	10,886,750	12,683,332

Source: NPS Cards Statistics

Mobile phone money transfer service usage continued to increase among the Kenyan public as indicated by the growth in the number of transactions which increased by 28.19 percent from 643.01 million transactions in the year to June 30, 2013 to 824.26 million transactions in the year to June 30, 2014. The Central Bank of Kenya continues to monitor the developments in this sector in line with the Government's policy of enhancing financial inclusion and deepening especially for rural/urban poor and the un-banked. The customer base for Mobile phone money transfer service increased by 9.17 percent from 23.75 million customers to 25.93 million customers, while the number of agents increased by 17.08 percent from 103,165 to 120,781 in the same period with M-Pesa accounting for 66.43 percent, Airtel 9.09 percent and Yu 7.21 percent. The value transferred through mobile money transfer services increased by 27.18 percent from Ksh 1,689.04 billion in the

year to June 30, 2013 to Ksh 2,148.13 billion for the year to June 30, 2014 (Table 12.7).

2. CASH INSTRUMENT

TABLE 12.7: MOBILE PHONE MONEY TRANSFER

Year to	2008	2009	2010	2011	2012	2013	2014
Amount transferred (Ksh billion)	61.07	318.44	597.31	919.22	1,375.83	1,689.04	2,148.13
Number of agents	3,011	10,735	31,902	46,588	61,313	103,165	120,781
Number of transactions (million)	21.77	125.12	251.25	364.06	507.90	643.01	824.26
Number of 'registered' customers/accounts (million)	3.04	7.39	10.44	17.99	19.80	23.75	25.93

Source: Service providers

Currency in circulation increased from Ksh 183.04 billion as at the end of June 2013 to Ksh199.97 billion as at end of June 2014 reflecting an increase of Ksh16.93 billion or 9.25 percent from the previous year's issued currency (Table 12.8). In weighted terms, bank notes account for 96.83 percent, while coins account for 3.17 percent of the currency in circulation. Notes in circulation grew by 6.94 percent from 404 million pieces in the year to June 30, 2013 to 432 million pieces in the

TABLE 12.8: CURRENCY IN CIRCULATION (NOTES & COINS)

	Jun-08		Jun-09		Jun-10		Jun-11		Jun-12		Jun-13		Jul-14	
Item	Ksh bn.	%	Ksh bn.	%	Kshs bn.	%	Kshs bn.	%	Ksh bn.	%	Ksh bn.	%	Ksh bn.	%
Currency in circulation	99.89	100.00	108.25	100.00	125.17	100.00	147.76	100.00	159.49	100.00	183.04	100.00	199.97	100
Bank Notes	96.14	96.25	104.22	96.27	120.72	96.44	143.07	96.83	154.60	96.93	177.49	96.97	193.64	96.83
Coins	3.75	3.75	4.04	3.73	4.45	3.56	4.69	3.17	4.89	3.07	5.55	3.03	6.33	3.17

Source: Central Bank of Kenya, Currency Division

TABLE 12.9: CURRENCY IN CIRCULATION (PIECES)

	Bank notes							Coins					
	2009/2010	2010/2011	2011/2012	2012/2013	2013/2014	% change		2009/2010	2010/2011	2011/2012	2012/2013	2012/2013	% change
	Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)			Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)	Pieces (m)	
1000=	90.22	108.99	119.66	138.58	151.52	9.33%	40=	2.25	2.51	5.71	9.41	9.36	-0.50%
500=	25.33	29.87	29.77	34.23	37.83	10.50%	20=	75.95	81.20	82.81	93.56	110.84	18.45%
200=	38.21	43.67	41.38	42.74	6.71	9.28%	10=	125.80	128.75	128.85	154.54	184.56	19.42%
100=	70.71	75.39	81.47	92.38	95.81	3.71%	5=	170.60	183.25	183.45	196.95	214.50	8.91%
50=	55.28	62.24	65.60	73.72	77.86	5.62%	1=	539.00	569.13	605.86	635.48	677.35	6.59%
20=	10.05	10.04	10.01	9.99	9.97	-0.22%	/50=	272.00	274.69	274.80	275.14	275.02	-0.05%
10=	12.00	11.99	11.96	11.94	11.92	-0.17%	/10=	360.00	358.61	358.53	0.00	0.00	0.00%
5=*	5.80	5.77	5.75	0.00	0.00	0.00%	/05=	300.00	305.10	305.06	0.00	0.00	0.00%
	307.60	347.96	365.62	403.59	431.61	6.94%		1,845.60	1,903.23	1,945.07	1,365.08	1,471.63	7.81%

*Dematerialised December 31, 2011

Source: Central Bank of Kenya, Currency Division

year to June 30, 2014. There was notable increase in the usage of Ksh 1,000, Ksh 500, Ksh 200 and Ksh50 notes that increased by 9.33 percent, 10.50 percent, 9.28 percent and 5.62 percent in the year to June 30, 2014 respectively while the circulation of the Ksh 20 and Ksh 10 notes decreased by 0.22 percent and 0.17 percent. Coins in circulation grew by

7.81 percent in the same period with the Ksh 20 coin, Ksh 10 coin, Ksh 5 coin and Ksh 1 coin increasing by 18.46 percent, 19.42 percent, 8.91 percent and 6.59, respectively. However, the Ksh 40 and Ksh 50 cents coins decreased by 0.50 percent and 0.05 percent, respectively. Public preference for bank notes explains the high proportion of currency in circulation being in bank notes than coins.

2.1 CASH INFLOWS AND OUTFLOWS

Deposits by banks (i.e. cash inflows) increased by 13.60 percent from Ksh 403.7 billion as at June 30, 2013 to Ksh 458.6 billion as at June 2014. Similarly withdrawals (i.e. cash outflows) increased by 7.81 percent from Ksh 426.5 billion to Ksh 474.6 billion in the same period. This reflects a net currency outflow in the year to June 30, 2014 of Ksh 16.8 billion (Table 12.10).

TABLE 12.10: CURRENCY INFLOWS AND OUTFLOWS (KSHS M)

Inflow by banks	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Bank Notes	283,083	271,257	175,149	384,996	403,678	458,568
Coins	376	248	29	21	9	18
Total	283,459	271,505	175,178	385,017	403,687	458,585
Outflows by banks						
Bank Notes	291,161	287,754	194,935	395,599	426,495	474,643
Coins	657	658	147	204	726	791
Total	291,818	288,412	195,082	395,803	427,221	475,434
Net Outflows	(8,359)	(16,907)	(19,904)	(10,786)	(23,534)	(16,848)

Source: Central Bank of Kenya, Currency Division

2.2 DEVELOPMENT IN COUNTERFEITING PRACTICES

Counterfeit activity increased marginally with the number of counterfeit notes increasing by 5.3 percent from 150 counterfeit notes in the year to June 30, 2013 to 158 counterfeit notes in the year to June 30, 2014 (Table 12.11). However, in value terms counterfeits decreased by 13.95 percent from Ksh 0.13 million in the previous year to Ksh 0.11 million in the year to June 30, 2014.

In terms of denomination, there were 88 pieces of Ksh 1,000 making up 55.70 percent, 27 pieces of Ksh 500 or 17.09 percent, 34 pieces of Ksh 200 or 21.52 percent, and 9 pieces of Ksh 100 or 5.70 percent of the counterfeit notes, respectively.

The reduction in value of counterfeits is attributed to enforcement of sorting guidelines issued to commercial banks. This initiative has resulted in more vigilance in the industry.

TABLE 12.11: COUNTERFEIT NOTES BY DENOMINATION

	Pieces						Proportion 2013/14
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	
1000/=	1,376	485	259	165	118	88	55.70%
500/=	442	113	75	35	10	27	17.09%
200/=	411	297	204	123	17	34	21.52%
100/=	60	143	72	8	5	9	5.70%
50/=	7	4	29	4	0	0	0.00%
20/=	0	0	0	2	0	0	0.00%
10/=	0	0	0	0	0	0	0.00%
5/=	0	0	0	0	0	0	0.00%
Total	2,296	1,042	639	353	150	158	100%

	Amounts (KSH)						Proportion 2013/14
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	
1000/=	1,376,000	485,000	259,000	165,000	118,000	88,000	80.59%
500/=	221,000	56,500	37,500	15,500	5,000	13,500	12.36%
200/=	82,200	59,400	40,800	24,600	34,000	6,800	6.23%
100/=	6,000	14,300	7,200	2,800	500	900	0.82%
50/=	350	200	1,450	200	0	0	0.00%
20/=	0	0	0	80	0	0	0.00%
10/=	0	0	0	0	0	0	0.00%
5/=	0	0	0	0	0	0	0.00%
Total	1,685,550	615,400	345,950	208,180	126,900	109,200	100%

Source: Central Bank of Kenya, Currency Department

3 CURRENT AND FUTURE DEVELOPMENTS

3.1 LEGAL FRAMEWORK

The NPS Act was operationalized with commencement date of March 24, 2014 through Kenya Gazette Supplement No. 30 of March 17, 2014 Legal Notice No. 32. In tandem, the Bank drafted the NPS regulations that await gazettelement following incorporation of stakeholder input.

The National Payment System Act 2011 makes provision for the regulation and supervision of payment systems and payment service providers, and for connected purposes. This reinforces the CBK mandate over payments systems as provided for in Section 4A 1(d) of the Central Bank of Kenya Act.

3.2 EAST AFRICAN CROSS BORDER PAYMENT SYSTEM

The East Africa Payments System (EAPS) System went live on November 25, 2013 and was officially launched on May 16, 2014. This is a regional payment system to facilitate safe and efficient cross border payments within the East African Community region. The system which integrates the RTGS in the

region uses the EAC member countries' currencies to settle intra EAC payment instructions on real time basis.

3.3 DEVOLUTION

In line with the Constitution of Kenya 2010, which established the devolved system of 47 County Governments, the CBK as a banker to the Government entrenched devolution in its operations in the year under review, by opening County Government accounts and addressing all operational requirements including training county officials which enabled smooth roll out of devolution.

3.4 INTERNET BANKING

Central Bank of Kenya in line with its vision 'To be a World Class Modern Central Bank' finalized and piloted the planned internet banking functionality to its clients. This platform will enable CBK clients transact with the Bank via internet for services such as Funds Transfer, On-line bidding for Government securities, Viewing of account balances and downloading and printing of account statements from anywhere in the world. Access to the functionality uses secure communication facilities supplied and managed by the Bank. The functionality is expected to be rolled out during the first quarter of the FY 2014 /15.

13. CURRENCY DEVELOPMENTS

Currency in Circulation

Overall currency in circulation increased by KShs. 16.6 billion in the year, a growth of 9 percent (Table 13.1).

TABLE 13.1: CURRENCY IN CIRCULATION

CENTRE	CIRCULATION JUNE 30 TH 2013 (KES.)	CIRCULATION JUNE 30 TH 2014 (KES.)
Nairobi	212,553,683,178.00	218,927,072,178.00
Mombasa	44,550,187,481.00	48,438,182,481.00
Kisumu	4,249,302,170.00	9,986,368,170.00
Eldoret	-66,685,537,122.00	-66,532,197,122.00
Nyeri	2,014,856,000.00	3,738,344,000.00
Nakuru	-20,124,026,000.00	-27,283,014,000.00
Meru	6,682,051,000.00	12,614,017,000.00
Total	183,240,516,707.00	199,888,772,707.00

Source: Central Bank of Kenya, Currency Operations and Branch Administration Department

Currency Centres

The three Currency Centres i.e. Nyeri, Nakuru and Meru account for a total of 15 percent of all Currency activities in the Country. The centres serve a total of 194 commercial bank branches.

New Banknote Generation

In line with Article 231 of Kenya's Constitution mandating the Central Bank of Kenya to issue currency notes and coins, the Bank on June 16, 2014, invited eligible banknote printers to prequalify for Production of Banknote Origination Material and Currency Printing Services.

50 Years of Independence Commemorative Currency

To celebrate Kenya's 50 years of independence, the Bank issued a commemorative gold coin. The coin is not intended for circulation and was issued in three forms; pure gold, gold plated silver and gold plated base metal in an acrylic block. These coins are available for sale to the public in any of the CBK Branches.

Combating Counterfeiting

The Bank continued with its efforts to create and enhance public awareness on security features of banknotes in an effort to ensure that counterfeiting is minimized. This saw the Bank get involved and well represented in the Nairobi International Trade Fair and the Mombasa, Kisumu, Eldoret, Nyeri, Nakuru, Meru and Kisii Agricultural Shows in a bid to score up public education on currency matters.

Regional Currency Convertibility

Regional Central Bank Governors signed the Memorandum of Understanding on Currency convertibility and repatriation among East African Partner States on May 16, 2014. This MOU will strengthen the convertibility and acceptability of EAC domestic currencies across the region and will further enhance trade and decrease transaction costs.

14. REGIONAL INTEGRATION DEVELOPMENTS

14. REGIONAL INTEGRATION DEVELOPMENTS

The Central Bank participates in a number of regional integration initiatives and programmes, particularly those relating to monetary and financial integration. These initiatives include the implementation of monetary and financial cooperation programmes of the East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and the Association of African Central Banks (AACB). This chapter reviews the progress in the implementation of macroeconomic convergence and other financial and monetary developments in the EAC, COMESA and AACB in 2013/14.

THE EAC MONETARY COOPERATION PROGRAMME

Background

In Articles 5, 82 to 85 of the EAC Treaty Partner States undertake to cooperate in monetary and fiscal matters in accordance with the approved macro-economic policies, harmonisation programmes and convergence framework. Partner States Central Banks through the Monetary Affairs Committee (MAC) of governors are mandated to steer aspects of the EAC treaty relating to monetary and financial cooperation. The MAC is tasked with laying the foundation for the establishment of a monetary union characterised by a single currency and one central bank for the region among other related aspects in East Africa.

The 17th Ordinary Monetary Affairs Committee (MAC) of the East African Community (EAC) was convened in Nairobi, Kenya from 12th to 16th May, 2014. The meeting considered among other things, the progress on implementation of decisions of the 16th Monetary Affairs Committee (MAC) Meeting held in Kampala in May 2013, priority issues to operationalize the East African Monetary Union (EAMU) Protocol and progress on IMF technical support to the EAMU process.

The Meeting noted that EAC central banks have made significant progress in enhancing financial and monetary integration in the EAC region. EAC central banks have made inroads in the harmo-

nization of monetary policy frameworks, harmonization of macroeconomic statistics, improvement in the payments system and financial markets development. The studies undertaken by MAC were used to inform the negotiation of the EAMU Protocol and which culminated in the adoption and signing of the Monetary Union Protocol on 30th November 2013 by the EAC Heads of State.

The signing of the Monetary Union Protocol represents a major milestone in the EAC regional integration process and provides for the formation of a single currency area with a common monetary and exchange rate policy and the establishment of the East African Central Bank (EACB). During the transition period, the Protocol provides for the establishment of the East African Monetary Institute (EAMI) to undertake preparatory work for transition to a single currency and attainment and maintenance of macroeconomic convergence. It also provides for the establishment of three other key institutions on surveillance, compliance and enforcement; statistics; and financial services oversight.

EAC Macroeconomic Convergence Criteria and Progress in 2014

Since May 2007, the Governors of EAC Partner States adopted a set of convergence criteria with the following timelines.

- Stage I (Year 2007-2010)
- Stage II (2011-2014)
- Stage III (2015)

The criteria were classified into primary and secondary criteria. The primary criteria are the preconditions for convergence, which need to be met while secondary criteria reinforce the primary criteria. The primary criteria include benchmarks on fiscal deficits, inflation and external reserves. The secondary criteria include areas of policy and real convergence.

Stage II (2011-2014)

Primary Criteria

- a) Overall Budget Deficit to GDP Ratio (excluding grants) not exceeding 5 percent; and Overall Budget deficit to GDP Ratio (including grants) not exceeding 2 percent;

- b) Annual Average Inflation Rate of not more than 5 percent;
- c) External Reserves of more than 6 months of imports of goods and non-factor services.

Secondary Criteria

- a) Maintenance of Market Based Interest Rates;
- b) Maintenance of high and sustainable rate of real GDP growth of not less than 7.0 percent;
- c) Sustained pursuit of debt sustainability;
- d) Domestic Savings to GDP Ratio of at least 20 percent;
- e) Maintenance of sustainable level of Current Account Deficit (excluding grants) as percentage of GDP; and
- d) Achievement of Sustainable Growth Rate of Real GDP of not less than 7.0 percent.

The East African Community's real GDP growth accelerated from 5.3 percent in 2012 to 6.1 percent in 2013 and is projected to increase further to 6.4 percent in 2014. Kenya and Tanzania recorded average growth rates of 5.7 percent and 7.0 percent respectively in 2013, compared to 4.5 percent and 6.9 percent in 2012. Growth in Uganda increased to 5.6 percent in 2013 from 2.8 percent in 2012 while Rwanda experienced decelerated growth averaging at 7.5 percent in 2013 from 8.0 percent in 2012. Real GDP growth in Burundi increased to 4.5 percent in 2013 from 4.0 percent in 2012. Inflation in the region dropped from 11.5 percent in 2012 to 6.9 percent in 2013 and is expected to maintain the downward trend in 2014 to 5.6 percent. The slowing pace of inflation is attributed to lower increases in food and fuel prices in the region. The rate of inflation however remained high in Burundi at 10.0 percent in 2013 from 11.8 percent in 2012. The rate of inflation in Kenya in 2013 declined to 5.7 percent from 9.4 percent in 2012. The rate of inflation in Tanzania, Uganda and Rwanda similarly declined to 8.5 percent, 5.0 percent and 5.7 percent respectively in 2013 compared to 16.0 percent, 14.0 percent and 6.3 percent respectively in 2012. The region's current account balance deficit as a percentage of GDP remained unchanged at 12.7 in 2013.

Kenya's performance with respect to each convergence criteria is provided in Table 14.1. Under the primary criteria, Kenya's annual average inflation increased to an average of 7.1 percent in the financial year 2013/2014 compared to 4.6 percent in the financial year 2012/2013 exceeding the EAC criteria of annual average inflation of not more than 5 percent. Kenya's budget deficit to GDP

ratio (excluding grants), worsened to 7.4 percent in the financial year 2013/14, exceeding the EAC stage II requirement of not more than 5 percent. Performance of the official external reserves improved from 4.4 months of import cover to 5.7 months of import cover. However, this was below the EAC target level of at least 6 months of import cover. On the secondary criteria, market based interest rates remained positive which was in line with the EAC requirement. With regards to GDP Growth Rate, Kenya's output increased to 5.7 percent in 2013 compared to 4.5 percent in 2012

TABLE 14.1: KENYA'S MACROECONOMIC PERFORMANCE AND CONVERGENCE UNDER THE EAC CRITERIA STAGE 2 (2011-2014)

Convergence criteria	Stages of implementation			Performance under Stage 2 (2011-2014)			
	Stage 1: 2007-2010	Stage 2: 2011-2014	Stage 3: 2015	2010/2011	2011/12	2012/13	2013/14
Primary Criteria							
Overall Budget Deficit to GDP ratio	Overall Budget Deficit to GDP Ratio (excluding grants) of not more than 6 percent	Overall Budget Deficit to GDP Ratio (excluding grants) not exceeding 5 percent		(5.5)	(5.7)	(6.7)	(7.4)
	Overall Budget Deficit to GDP Ratio (including grants) of not more than 3 percent	Overall Budget deficit to GDP Ratio (including grants) not exceeding 2 percent		(4.3)	(5.5)	(5.7)	(6.2)
Annual average Inflation Rate	Not exceeding 5 percent	Not exceeding 5 percent		6.9	16.0	4.6	7.1
External Reserves (months of import of imports of goods and non-factor services)*	More than 4 months of imports of goods and non-factor services	More than 6 months of imports of goods and non-factor services		3.8	4.3	4.4	5.7
Secondary Criteria							
Exchange Rates	Achievement and maintenance of Stable Real Exchange Rates						
Interest rates (Market based)****	Achievement and maintenance of positive Market Based Interest Rates	Maintenance of positive Market Based Interest Rates		(0.6)	5.1	2.4	
GDP Growth Rate At Factor Cost-constant prices**	Achievement of sustainable Real GDP Growth Rate of not less than 7.0 percent	Maintenance of high and sustainable rate of real GDP growth of not less than 7.0 percent	Introduction and circulation of a single East African Currency	6.1	4.5	5.7	
Debt reduction and sustainability	Sustained pursuit of debt reduction initiative on domestic and foreign debt i.e. reduction of total debt as a ratio of GDP to a sustainable level	Sustained pursuit of debt sustainability		24.1	23.0	24.7	27.0
National Savings to GDP ratio***	Not less than 20 percent	At least 20 percent		11.5	9.0	9.4	
Current Account Deficit percentage to GDP	Reduction of Current Account Deficit (Excluding grants) as a percentage of GDP to sustainable level consistent with debt sustainability	Maintenance of sustainable level of Current Account Deficit (excluding grants) as percentage of GDP		(7.0)	(8.9)	(9.3)	(8.5)
Implementation of the 25 Core Principles of Bank Supervision and Regulation	Implementation of the 25 Core Principles of Bank Supervision and Regulation based on agreed Action Plan for Harmonization of Bank Supervision					
Adherence to the Core Principles for Systematically Important Payment Systems	Adherence to the Core Principles for Systematically Important Payment Systems by modernizing payment and settlement systems					

* Based on an average of 36 months import

** at Constant Market Prices, Calendar year beginning 2011: Source Kenya National Bureau of Statistics

***at Current Market Prices, Calendar year beginning 2011

****91 day Treasury Bills Real Interest Rates Calendar year: Source 2014 Economic Survey

Convergence criteria source: EAC MAC report 2009

but failed to meet the convergence criteria of maintaining real GDP growth rate of not less than 7.0 percent. The ratio of National Savings to GDP improved marginally to 9.4 percent in 2013 from 9

percent in 2012 but remained below the EAC requirement of a minimum of 20 percent.

THE COMESA MONETARY COOPERATION PROGRAMME

Background

The mandate to establish a Monetary Union in the COMESA region is derived from Article 4 (4) of the COMESA Treaty signed in Kampala, Uganda on November 5, 1993, which states that the Member States shall “in the field of monetary affairs and finance, co-operate in monetary and financial matters and gradually establish convertibility of their currencies and a payments union as a basis for the eventual establishment of a monetary union”. To be consistent with the Africa Monetary Cooperation Programme led by the Association of African Central Banks and to fast track achievement of a monetary union, the Seventh Meeting of the Ministers of Finance held in Lusaka, Zambia in November, 2005 adopted revised macroeconomic convergence criteria aimed at establishing a monetary union in COMESA by 2018.

The revised convergence criteria, are categorized into primary (pre-conditions for convergence) and secondary (reinforcement conditions) criteria, to be implemented in three phases;

- Stage 1 (2005-2010),
- Stage 2 (2011-15) and;
- Stage 3 (2016-18).

The following are convergence criteria in the second stage.

Primary Criteria:

- (a) Overall budget deficit/GDP ratio (excluding grants) of not more than 4 percent.
- (b) Annual average inflation rate not exceeding 3 percent.
- (c) Eliminate central bank financing of the budget.
- (d) External reserves of equal to or more than 5 months of imports of goods and non-factor services.

Secondary Criteria

- (a) Achievement and maintenance of stable real exchange rates.
- (b) Achievement and maintenance of market based positive real interest rates.
- (c) Achievement of a sustainable real growth rate of real GDP of not less than 7 percent.
- (d) Pursuit of debt reduction initiative on domestic and foreign debt i.e. reduction of total debt as a ratio of GDP to a sustainable level.
- (e) Total domestic revenue to GDP ratio of at least 20 percent.
- (f) Maintenance of current account deficit (excluding grants) as a percentage of GDP to sustainable level.
- (g) Achievement and maintenance of domestic investment rate of at least 20 percent.
- (h) Gradual liberalisation of the Capital Account.

Kenya's Progress in the Implementation of COMESA Monetary Harmonization Programme

In the year to June 2014, Kenya met one of the three primary convergence criteria of the second stage of the COMESA Monetary Harmonisation Programme.

Kenya's official external reserves at 5.7 months of import cover in June 2014 were above the necessary 5 months of import cover for the COMESA Monetary Harmonization Target. The overall budget deficit (excluding grants) to GDP ratio worsened to 7.4 percent in the year to June 2014 from 6.7 percent in the year to June 2013, exceeding the COMESA target of not more than 4 percent. The overall annual average inflation rate increased from 4.6 percent in the year to June 2013 to 7.1 percent in the year to June 2014 and was above the COMESA target of 3 percent.

Kenya however, met several of the secondary criteria targets with the real effective exchange rate remaining relatively stable over the

TABLE 14.2: KENYA'S PROGRESS IN IMPLEMENTATION OF COMESA MONETARY CO-OPERATION PROGRAMME DURING STAGE 2 (YEAR 2011-2015)

	Stages of implementation			Performance under Stage 2 (2011-2014)			
	Stage 1: 2005-2010	Stage 2: 2011-2015	Stage 3: 2016-2018	2010/2011	2011/12	2012/13	2013/14
Convergence criteria							
Primary Criteria							
Overall Budget Deficit to GDP ratio	Overall Budget Deficit to GDP Ratio (excluding grants) of not more than 5 percent	Overall Budget Deficit to GDP Ratio (excluding grants) not exceeding 4 percent	Overall Budget Deficit to GDP Ratio (excluding grants) not exceeding 3 percent	(5.5)	(5.7)	(6.7)	(7.4)
Annual average Inflation Rate	Not exceeding 5 percent	Not exceeding 3 percent	Not exceeding 3 percent	6.9	16.0	4.6	7.1
Central Bank financing of the budget deficit	Minimise towards 0 percent	Eliminate	Eliminate				
External Reserves (months of import of goods and non-factor services)*	Equal to or more than 4 months of imports of goods and non-factor services	Equal to or more than 5 months of imports of goods and non-factor services	Equal to or more than 6 months of imports of goods and non-factor services	3.8	4.3	4.4	5.7
Secondary Criteria							
Stable real exchange Rates	To be achieved and maintained	To be achieved and maintained	To be achieved and maintained	74.3	72.2	65.4	62.7
Market based positive real interest rates****	To be achieved and maintained	To be achieved and maintained	To be maintained	(0.6)	5.1	2.4	
Achievement and maintenance of sustainable real growth rate of real GDP**	Not less than 7.0 percent	Not less than 7.0 percent	Not less than 7.0 percent	6.1	4.5	5.7	
Debt reduction initiative on domestic and foreign debt, i.e reduction of total debt as a ratio of GDP	To be kept at a sustainable level	To be kept at a sustainable level	To be sustained	24.1	23.0	24.7	27.0
Total domestic revenue to GDP ratio***	Not less than 20 percent	At least 20 percent	At least 20 percent	21.4	19.7	20.4	21.0
Current Account Deficit (excluding grants) percentage to GDP	To be reduced to a sustainable level	To be maintained and sustained	To be maintained and sustained	(7.0)	(8.9)	(9.3)	(8.5)
Achievement and maintenance of domestic investment rate	At least 20 percent	At least 20 percent	At least 20 percent	21.0	20.0	18.0	
25 Core Principles of bank supervision and regulation based on agreed action plan for harmonisation of bank supervision for the COMESA region	To be implemented				
Core principles for systematically important payment systems, by modernising the payment and settlement system	To be adhered to				
Liberalisation of the capital account		Gradual	Full				

* Based on average of 36 months import

** at Constant Market Prices, Calendar year beginning 2011: Source Kenya National Bureau of Statistics

***at Current Market Prices, Calendar year beginning 2011

****91 day Treasury Bills Real Interest Rates Calendar year: Source 2014 Economic Survey

period, market based interest rates remaining positive and the country achieving gradual liberalisation of the Capital account. . Total domestic revenue to GDP ratio at 21 percent in the year to 2014 was above the 20 percent COMESA requirement. Real GDP growth rate however, remained below the COMESA requirement of 7 percent despite increasing in 2013. The domestic investment rate at

18 percent in 2013 was below the COMESA requirement of 20 percent.

THE AFRICAN MONETARY COOPERATION PROGRAMME (AMCP)

3.1 Background

The AMCP was adopted during the 26th ordinary Assembly of the Association of African Central Banks (AACB) Governors held in Algiers on September 4, 2002. The programme involves the adoption of collective policy measures aimed at implementing a harmonized monetary system and common management institution in Africa. It envisages the harmonization of the monetary cooperation programme of the various sub regional groupings as building blocks with the ultimate aim of evolving to a single monetary zone by the year 2021 with a common currency and a common central bank at the continental level. It has both primary and secondary convergence criteria which should be attained by at least 51 percent of the AACB Membership before the launching of the African Monetary Union by 2021.

3.2 Progress in Implementation of the AMCP

Stage III Criteria (Year 2009 - 2012)

Observance of the following macroeconomic indicators by year 2012.

- Budget deficit/GDP ratio not exceeding 3 percent by 2012.
- Elimination of Central Bank credit to government.
- Inflation rate of less than 5 percent.
- External reserves/imports cover of equal or greater than 6 months.

Stage IV Criteria (Year 2013 - 2015)

Assessment of macroeconomic performance and negotiation for the establishment of a common Central Bank (Year 2015).

- Consolidation of achievements made at the third stage.
- Inflation rate of less than 3 per cent.
- Continued observance of macroeconomic indicators of convergence.
- Assessment of macroeconomic indicators of each country against the convergence criteria.

- Comparative analysis to be made to the Convergence Council.
- Commissioning of a study on the establishment of an African Exchange Rate Mechanism.

TABLE 14.3: MACROECONOMIC PERFORMANCE AGAINST CONVERGENCE CRITERIA UNDER THE AMCP IN 2014 – AACB EASTERN AFRICA REGION

AMCP Targets for Stage IV (2013 – 2015)						
Primary Criteria						
	Targets for Stage III (2009 – 2012)	Targets for Stage IV (2013 – 2015)	Performance under Stage 2 (2011-2014)			
			2010/2011	2011/12	2012/13	2013/14
Overall Budget deficit/GDP excluding grants	not exceeding 3% by 2012	Continued observance of stage 3 criteria	(5.5)	(5.7)	(6.7)	(7.4)
Inflation rate Annual Average	less than 5 percent per annum	less than 3 percent per annum	6.9	16.0	4.6	7.1
Elimination of Central Bank Credit to Government	Eliminate	Eliminate	0.3	0.2	0.2	0.3
External reserves months of Imports cover*	equal or greater than 6 months	Continued observance of stage 3 criteria	3.8	4.3	4.4	5.7
Secondary Criteria						
	Targets for Stage III (2009 – 2012)		Jun-11	Jun-12	Jun-13	Jun-14
Domestic fiscal Receipts/GDP ratio**	equal to or more than 20%	Continued observance of stage 3 criteria	21.4	19.7	20.4	21.0
Salary mass/total domestic fiscal receipt ratio	Less than 35 percent	Continued observance of stage 3 criteria	32.6	32.5	34.9	36.6
The sourcing of minimum of 20% Government investment capital from fiscal receipts	equal to or more than 20%	Continued observance of stage 3 criteria	27.1	27.3	23.8	29.5
Current Account/GDP ratio	Sustainable level	Continued observance of stage 3 criteria	(7.0)	(8.9)	(9.3)	(8.5)
Real effective exchange rate	Maintenance of real exchange rate stability	Continued observance of stage 3 criteria	74.3	72.2	65.4	62.7

* Based on 36 months average of imports

** Based on revenues as a percent of GDP at current market prices for each fiscal year

Table 14.3 shows Kenya's performance in the implementation of the AMCP. Kenya's overall deficit to GDP ratio (excluding grants) declined to 7.4 percent in the fiscal year 2013/14 but was above the AMCP target of 3 percent. The overall annual average inflation rate rose to 7.1 percent which was above the 3 percent AMCP target. Kenya's external reserve position improved to 5.7 months of import cover as at June 2014. The increase is mainly attributed to the proceeds received from the sale of the Eurobond in June 2014. Domestic fiscal receipts to GDP at 21.0 percent were above

15. ECONOMIC OUTLOOK

The National Treasury projects the Kenya economy to expand by 6.1 percent in the twelve months to June 2015 (from an estimated 5.5 percent in the previous year) partly supported by stability in domestic prices and the exchange rate, and recovery in the global economy. In addition, recent discoveries of natural resources (largely oil and gas) are likely to trigger an increase in foreign direct investment which is expected to impact domestic production positively. Commencement of envisaged public sector infrastructure projects will provide an additional boost to growth.

It is envisaged that the Government will continue to implement pro-growth policies in the year to June 2015. In this regard, the Central Bank of Kenya will continue to implement prudent monetary policy to stabilize inflationary expectations with the CBR coordinating short term interest rates, especially the interbank rate. In order to coordinate commercial banks' lending rates and enhance transparency in the pricing of credit, the Central Bank of Kenya launched effective July 8, 2014, the Kenya Bank's Reference Rate (KBRR). The KBRR rate is based on Central Bank rate and Treasury bills rate and all banks and mortgage finance companies are expected to disclose the premium above the base rate. This is expected to increase transparency in commercial banks' lending and to enhance transmission between the CBR to commercial bank's lending rate, and ultimately supply of private sector credit.

The banking sector is expected to sustain the growth momentum supported by stable macroeconomic environment, domestic and regional expansion of bank branches and continued improvement in the implementation of the devolved system of Government. Following the successful issuance of the Euro Bond in June 2014, the fiscal stance in the twelve months

to June 2015 will complement monetary policy in ensuring stable macroeconomic environment conducive to economic recovery. Risks to the outlook however, may include forecast erratic rains posing a threat to electricity generation and water supply leading to higher costs of energy; and insecurity concerns in the tourism sector.

APPENDIX

Appendix: Macroeconomic Indicators for Selected African Countries for the Period 2010-13

Country	Subject Descriptor	2010	2011	2012	2013
Real GDP growth (%)					
Burundi	Gross domestic product, constant prices	5.1	4.2	4.0	4.5
Ethiopia	Gross domestic product, constant prices	10.6	11.4	8.5	9.7
Ghana	Gross domestic product, constant prices	8.0	15.0	7.9	5.5
Kenya	Gross domestic product, constant prices	8.4	6.1	4.5	5.7
Nigeria	Gross domestic product, constant prices	8.0	7.4	6.6	6.3
Ruanda	Gross domestic product, constant prices	7.2	8.2	8.0	5.0
South Africa	Gross domestic product, constant prices	3.1	3.6	2.5	1.9
Tanzania	Gross domestic product, constant prices	7.0	6.4	6.9	7.0
Uganda	Gross domestic product, constant prices	6.2	6.2	2.8	6.0
Inflation rate (%) (end of period)					
Burundi	Inflation, end of period consumer prices	4.1	14.9	12.0	8.8
Ethiopia	Inflation, end of period consumer prices	14.6	35.9	14.9	7.7
Ghana	Inflation, end of period consumer prices	8.6	8.6	8.8	13.5
Kenya	Inflation, end of period consumer prices	5.8	18.9	3.2	7.1
Nigeria	Inflation, end of period consumer prices	11.7	10.3	12.0	7.9
Ruanda	Inflation, end of period consumer prices	0.2	8.3	3.9	3.6
South Africa	Inflation, end of period consumer prices	3.5	6.1	5.7	5.4
Tanzania	Inflation, end of period consumer prices	5.6	19.8	12.1	5.6
Uganda	Inflation, end of period consumer prices	3.1	27.0	5.3	5.6
General Government Debt as % of GDP					
Burundi	General government gross debt	40.3	36.4	35.4	31.7
Ethiopia	General government gross debt	27.9	26.2	21.2	22.2
Ghana	General government gross debt	46.3	43.7	51.2	60.1
Kenya	General government gross debt	55.1	52.6	50.5	50.5
Nigeria	General government gross debt	15.5	17.2	18.4	19.4
Ruanda	General government gross debt	23.1	23.9	24.1	29.4
South Africa	General government gross debt	35.9	38.8	42.1	45.2
Tanzania	General government gross debt	37.1	40.2	40.4	41.0
Uganda	General government gross debt	26.8	29.3	31.1	33.9
Current Account Balance as % of GDP					
Burundi	Current Account Balance	-12.2	-13.6	-17.3	-23.2
Ethiopia	Current Account Balance	-4.1	-0.7	-6.5	-6.1
Ghana	Current Account Balance	-8.6	-9.1	-12.2	-13.2
Kenya	Current Account Balance	-6.3	-7.9	-8.5	-8.7
Nigeria	Current Account Balance	5.8	3.5	7.7	4.7
Ruanda	Current Account Balance	-5.4	-7.2	-11.4	-7.3
South Africa	Current Account Balance	-2.0	-2.3	-5.2	-5.8
Tanzania	Current Account Balance	-9.3	-14.5	-15.9	-14.3
Uganda	Current Account Balance	-11.1	-12.5	-10.5	-11.7

Source: IMF, World Economic Outlook Database, April 2014

REPUBLIC OF KENYA



KENYA NATIONAL AUDIT OFFICE

**REPORT
OF
THE AUDITOR-GENERAL
ON
CENTRAL BANK OF KENYA
FOR THE YEAR ENDED
30 JUNE 2014**

FINANCIAL PERFORMANCE

REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE CENTRAL BANK OF KENYA AT 30 JUNE 2014

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CENTRAL BANK OF KENYA
BANK INFORMATION
FOR THE YEAR ENDED 30 JUNE 2014

Prof Njuguna Ndung'u	Governor
Dr Haron Sirima	Deputy Governor
Mr Kennedy K. Abuga	Director – Governors' Office and Board Secretary
Mr Aggrey J. K. Bett	Director – Special Projects up to 2 April 2014
Ms Rose Detho	Director – Strategic Management Department – Appointed on 2 April 2014
Mr Fredrick Pere	Director – Bank Supervision Department
Mr Charles Koori	Director – Research Department
Mr Cassian J. Nyanjwa	Director – Department of Estates, Supplies and Transport
Mr Paul K. Wanyagi	Ag. Director – Currency Operations and Branch Administration Department
Mr Gerald Nyaoma	Director – Financial Markets Department
Mr Peter K. Rotich	Director – Finance & Information Management Systems Department
Mr Mark Lesiit	Director – Banking & Risk Management Department
Ms Mary Waceke	Director – Human Resources and Administration Department

Prof Kinandu Muragu Executive Director – Kenya School of Monetary Studies

Mr William Nyagaka Director – Internal Audit Department

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 40100 Kisumu

Eldoret Branch

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 30100 Eldoret

Currency centres

Nyeri Currency Centre

Kenya Commercial Bank Building
 Building
 Kenyatta Street
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 10100 Nyeri
 Kenya

Meru Currency Centre

Co-operative Bank Building

 Njuri Ncheke Street
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Nakuru Currency Centre

Central Bank of Kenya

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CENTRAL BANK OF KENYA
BANK INFORMATION - CONTINUED
FOR THE YEAR ENDED 30 JUNE 2014

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Certified Public Accountants
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Kenya

On behalf of:-

Auditor General

Anniversary Towers
P O Box 30084
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Kenya

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE
FOR THE YEAR ENDED 30 JUNE 2014

1. Statement of Corporate Governance

The Central Bank of Kenya (the “Bank”) is wholly owned by the Government of Kenya. The Bank is established by and derives its authority and accountability from Article 231 of the Constitution of Kenya. The Bank is committed to maintaining the highest standards of integrity, professionalism and business ethics in all its operations.

1.1. Board of Directors

The Central Bank of Kenya Act provides that the Board of Directors shall be composed of a Chairperson, a Governor, the Principal Secretary to the National Treasury, who is a non-voting member and five Non-Executive Directors including the Chairperson. Previously, all the Board members were appointed by the President of the Republic of Kenya. With effect from 2nd May, 2012, the Act was amended and now requires under Sections 11(2A) and 13(1) that the Chairperson of the Board and the Governor of the Bank, respectively, be appointed by the President through a transparent and competitive process and following the approval of Parliament. The current Directors, in line with the provisions of the Act, Section 12 (1C), elected an Interim Chairperson from amongst the members to preside at meetings of the Board until a substantive Chairperson is appointed. Consequently, Dr Mbui Wagacha was on February 11, 2013 elected to preside at meetings of the Board. Other than the Principal Secretary to the Treasury who is ex-officio, all the Non-Executive Directors of the Board are appointed by the President of the Republic of Kenya. All the Board members are appointed for terms of four years each and are eligible for reappointment provided that no Board Member holds office for more than two terms.

There are five Non-Executive Directors namely Dr Mbui Wagacha, Mr John Gerin Msafari, Ms Vivienne Yeda Apopo and Ms Florence Kagendo Muindi who are all serving their first term and Prof William Otiende Ogara who is serving his second term. All the Non-Executive Directors are independent of management and free from any business or other relationship, which could interfere with the exercise of their independent judgement.

The Board meets once every two months and has a formal schedule of agenda items due for deliberations. The Directors are given appropriate and timely information to maintain full and effective control over strategic, financial and operational issues. The Board is not involved in the conduct of day-to-day business as this is the responsibility given to the Governor by the Act. It, however, retains responsibility for determining the policy of the Bank.

The Members of the Board as at 30 June 2014 and their attendance of the 13 meetings held in the year were as follows:

No	Name	Position	Discipline	Date of appointment	Nationality	Meetings attended
1	Dr Mbui Wagacha	Interim Chairperson	Economist	14 March 2011	Kenyan	13
2	Prof Njuguna Ndungu	Governor, Member	Economist	14 March 2011	Kenyan	13
3	Prof William Otiende Ogara	Member	Professional Accountant	14 March 2011	Kenyan	13
4	Mr John Gerin Msafari	Member	Business management	1 June 2011	Kenyan	12
5	Ms Vivienne Yeda Apopo	Member	Lawyer and banker	14 March 2011	Kenyan	7
6	Ms Florence Kagendo Muindi	Member	Human Resource	1 June 2011	Kenyan	13
7	Principal Secretary, National Treasury	Executive Officer	Economist	Permanent	Kenyan	3

The remuneration paid to the Directors for services rendered during the financial 2013/2014 is disclosed in Note 29 of the financial statements. The Non-Executive Directors are paid a monthly retainer fee and a sitting allowance for every *meeting* attended. There were no loans to Non-Executive Directors during the year while the Executive Director is paid a monthly salary and is eligible for staff loans.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)
FOR THE YEAR ENDED 30 JUNE 2014

1. Statement of Corporate Governance (continued)

1.2 Audit Committee

The members of the Audit Committee are Prof William Otiende Ogara (Chairman), Mr John Gerin Msafari, Ms Florence Muindi and Ms Vivienne Yeda Apopo. The members are all Non-Executive Directors having experience in Accounting, Auditing, Economics, Banking, Financial and Business Management and Legal matters. The Committee currently meets once every two months and as necessary. The Terms of Reference for the Audit Committee cover five major areas, namely, Internal Control, Financial Reporting, Risk Management, Internal Audit and External Audit.

The Audit Committee's mandate under **Internal Control** covers evaluation of control culture; the adequacy of the internal control systems and compliance with International Financial Reporting Standards in preparation of financial statements; the overall effectiveness of the internal control and risk management frameworks; and review of the effectiveness of the system for monitoring compliance with laws and regulations.

The mandate relating to **Financial Reporting** requires the Audit Committee to review significant accounting and reporting issues and their impact on the financial reports and ensure current financial risk areas are being managed appropriately. The Committee also ensures the adequacy of the financial reporting process and reviews the Bank's monthly management accounts and annual financial statements before approval by the Board and release.

With regard to **External Audit**, the Audit Committee reviews the external auditor's proposed audit scope, approach and audit deliverables; and review draft financial statements before submission to the External Auditor for audit.

The Committee's mandate on **Internal Audit** covers review of the activities and resources of the Internal Audit function; effectiveness, standing and independence of internal audit function within the Bank; review of the internal audit plan; and follow up of implementation of internal auditor's findings and recommendations. The Audit Committee reports to the Board of Directors on the standing and independence of internal audit function within the Bank; review of the internal audit plan; and follow up of implementation of internal auditor's findings and recommendations. The Audit Committee reports to the Board of Directors on approach and audit deliverables; and review draft accounts before submission to the External Auditors for audit.

The Members of the Audit Committee as at 30 June 2014 and their attendance of the 16 meetings held in the year were as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Prof William Otiende Ogara	Chairman	Professional Accountant	Kenyan	15
2	Mr John Gerin Msafari	Member	Business Management	Kenyan	15
3	Ms Florence Kagendo Muindi	Member	Human Resource	Kenyan	16
4	Ms Vivienne Yeda Apopo	Member	Lawyer and Banker	Kenyan	3

1.3 Monetary Policy Committee (MPC)

Section 4D of the CBK (Amendment) Act 2008 establishes the Monetary Policy Committee. The committee is responsible for formulating monetary policy and is required to meet at least once in two months. Members of the committee are appointed by the Cabinet Secretary for Finance for an initial period of three years each and may be reappointed for another final term of three years.

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)
FOR THE YEAR ENDED 30 JUNE 2014

1. Statement of Corporate Governance (continued)

1.3 Monetary Policy Committee (MPC) (continued)

The Members of the MPC as at 30 June 2014 and their attendance of the 6 meetings held in the year were as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Prof Njuguna Ndungu	Chairman	Economist	Kenyan	6
2	Dr Haron Sirima	Vice Chairman	Economist	Kenyan	6
3	Principal Secretary, National Treasury	Member	Economist	Kenyan	6
4	Prof Francis Mwega	Member	Economist	Kenyan	6
5	Prof Terry C. Ryan	Member	Economist	Kenyan	6
6	Mrs Sheila Mbijjewe	Member	Finance	Kenyan	6
7	Mrs Farida Abdul	Member	Economist	Kenyan	6
8	Mr Charles Koori	Internal-Member	Economist	Kenyan	6
9	Mr John K. Birech	Internal-Member	Economist	Kenyan	6

1.4 Human Resources Committee

The committee meets once every two months and when need arises to review human resource policies and make suitable recommendations to the Board.

The members of the Human Resources Committee as at 30 June 2014 and their attendance of the 5 meetings held in the year were as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Ms Florence Kagendo Muindi	Chairperson	Human Resource	Kenyan	5
2	Prof William Otiende Ogara	Member	Professional Accountant	Kenyan	5
3	Mr John Gerin Msafari	Member	Business management	Kenyan	4
4	Ms Vivienne Yeda Apopo	Member	Lawyer and banker	Kenyan	1

There were 4 Special Human Resource Committee meetings held in the year, the attendance of which was as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Ms Florence Kagendo Muindi	Chairperson	Human Resource	Kenyan	4
2	Prof William Otiende Ogara	Member	Professional Accountant	Kenyan	4
3	Mr John Gerin Msafari	Member	Business management	Kenyan	3
4	Ms Vivienne Yeda Apopo	Member	Lawyer and banker	Kenyan	1
5	Dr Mbui Wagacha	In attendance	Economist	Kenyan	2

1.5 Financial Stability and Investment Committee

The committee meets regularly and as and when need arises to review financial stability issues and provide oversight of foreign reserves management and investment policies and make suitable recommendations to the Board.

Members of this committee who served during the year are as follows:

No	Name	Position	Discipline	Nationality	Meetings attended
1	Ms Vivienne Yeda Apopo	Chairperson	Lawyer and Banker	Kenyan	2
2	Prof William Otiende Ogara	Member	Professional Accountant	Kenyan	2
3	Dr Mbui Wagacha	Member	Economist	Kenyan	2

CENTRAL BANK OF KENYA
STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)
FOR THE YEAR ENDED 30 JUNE 2014

1. Statement of Corporate Governance (continued)

1.6 Management Structure

The Central Bank's Senior Management team is made up of the Governor, the Deputy Governor and the heads of the Bank's various departments as indicated on **page 74**. The positions of Governor and Deputy Governor are set out in the CBK Act Cap 491 of the Laws of Kenya. The Senior Management meets regularly to review the overall performance of the Bank.

There are several other management committees, which advise the Governor on specific issues in order to enable him to discharge his responsibilities as the Chief Executive Officer of the Bank.

1.7 Code of Ethics

The Bank is committed to the highest standards of integrity, behaviour and ethics. A formal code of ethics for all employees has been approved by the Board and is fully implemented. All employees of the Bank are expected to avoid activities and financial interests which could give rise to conflict of interest with their responsibilities in the Bank. Strict rules of conduct apply to the entire Bank's staff under the staff rules and regulations.

1.8 Internal Controls

Management of the Bank has put in place a series of internal control mechanisms to ensure the reporting of complete and accurate accounting information. Procurement of goods and services is strictly done in accordance with the Public Procurement & Disposal Act, 2005. In all operational areas of the Bank, workflows have been structured in a manner that allows adequate segregation of duties.

1.9 Authorizations

All the expenditure of the Bank must be authorized in accordance with a comprehensive set of Bank policies and procedures. There is a budget and a procurement plan that is prepared and approved by the Board before commencement of the financial year. The Board of Directors receives regular management accounts comparing actual outcomes against budget as a means of monitoring actual financial performance of the Bank.

1.10 Internal Audit and Risk Management

The internal audit function is performed by Internal Audit Department. Risk Management Unit is a separate function under the Banking Department and is responsible for monitoring and providing advice on the Bank's risk management framework. All reports of the Internal Audit Department and Risk Management Unit are availed to the Audit Committee of the Board.

1.11 Corporate Reporting

The Bank publishes an Annual Report, Monthly Economic Review, Weekly Releases, Statistical Bulletin and Bi-annual Monetary Policy Statement which explains current monetary policy and also provides the expected monetary policy stance. In addition, the Bank issues policy briefs to the Treasury on both the monetary and fiscal policies. On an annual basis, the financial statements are published in the Kenya Gazette and are also placed in the Bank's website.

CENTRAL BANK OF KENYA
FINANCIAL PERFORMANCE
FOR THE YEAR ENDED 30 JUNE 2014

2 Financial Performance

The Bank's financial performance is affected by monetary policy undertaken, money supply, interest rates and exchange rate. The Bank's financial performance is presented on **page 85** of these financial statements.

During the financial year ended 30 June 2014, the Bank's net interest income after impairment charge was Shs 4,757 million (2013: Shs 1,912 million). The increase is due to reduction of monetary policy expenses attributed to the stance taken by the Monetary Policy Committee.

The Bank's unrealized foreign exchange gains went up significantly to Shs 14,759 million (2013: Shs 5,623 million) due to increased levels of foreign exchange reserves together with a weakening shilling in the year under review.

Net trading income mainly generated from sale of foreign currency increased to Shs 2,245 million (2013: Shs 1,699 million) due to movements in major foreign currency exchange rates and major government repayments during the year.

Operating expenses increased significantly to Shs 12,177 million (2013: Shs 9,404 million) as a result of the write off of the unamortized portion relating mainly to the cost of currency notes in issue in the year of Shs 1,254 million following a change in the estimated useful lives of the various currency notes denominations. See note 2(t). The cost of currency coins also increased by Shs 780 million in the year to Shs 1,756 million (2013: Shs 976 million). Staff expenses increased by 7% to Shs 3,899 million (2013: Shs 3,645 million).

Currency costs are expected to significantly increase in the next financial year (2014/15) as the Bank plans to issue new generation currency to comply with constitutional requirements.

The outcome of the Bank's operations was a net surplus of Shs 13,504 million (2013 restated: Shs 3,573 million) which has been added to the general reserve fund.

The financial position for the year is set out on **page 86**.

The amendments to *IAS 19 Employee Benefits* effective for the period starting on or after 1 January 2013 have been applied by the Bank for the first time. The revised standard requires that all actuarial gains and losses arising in any given year be recognised immediately in other comprehensive income. The largest impact of the adoption has been an increase in the pension asset relating to unrecognized actuarial gains posted to other comprehensive income as a prior year adjustment. This has led to an increase in 1 July 2013 opening pension asset by Shs 5,141 million. Additional disclosures have been made in the financial statements in accordance with the revised standard in notes 2 and 17 to the financial statements. The retrospective effect of the standard has been incorporated on the financial statements, including the inclusion of a third column in the Statement of Financial Position relating to the restated position at 30 June 2012, in accordance with International Financial Reporting Standard requirements.

The Bank's assets increased to Shs 854,604 million (2013 restated: Shs 595,530 million) fostered by receipts from diaspora, receipt of the \$2bn Eurobond in June 2014 and movement in exchange rates in the year.

Liabilities on the other hand increased to Shs 784,212 million (2013: Shs 537,470 million) due to higher liquidity as evidenced by higher deposits from banks and government at Shs 448,800 million (2013: Shs 191,671 million), currency in circulation at Shs 199,966 million (2013: Shs 183,047 million) and IMF at Shs 130,064 million (2013: Shs 118,568 million).

CENTRAL BANK OF KENYA
DIRECTORS' REPORT
FOR THE YEAR ENDED 30 JUNE 2014

The Directors submit their report together with the audited financial statements for the year ended 30 June 2014, which shows the state of affairs of Central Bank of Kenya (the "Bank").

Incorporation

The Bank is incorporated under Article 231 of the Constitution of Kenya, 2010.

Principal activities

The Bank is established and administered under the Constitution of Kenya, 2010 with the principal object of formulating and implementing monetary policy directed to achieving and maintaining stability in the general level of prices. It is also the responsibility of the Bank to foster liquidity, solvency and proper functioning of a stable market-based financial system. The Bank also acts as banker, advisor and fiscal agent of the Government of Kenya.

Results and dividend

The surplus for the year of Shs 13,504 million (2013 restated: Shs 3,573 million) has been added to the general reserve fund. The Directors do not recommend the payment of a dividend (2013: Nil).

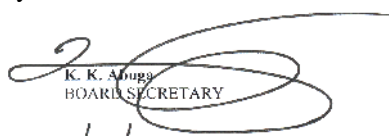
Board of Directors

The Board of Directors who served during the year and up to the date of this report are listed on **page 74**.

Auditors

The Bank is audited by the Auditor General in accordance with Section 12 of the Public Audit Act and the Central Bank of Kenya Act.

By order of the Board


 K. K. Abaga
 BOARD SECRETARY
 4/9/ 2014

CENTRAL BANK OF KENYA
STATEMENT OF DIRECTORS' RESPONSIBILITY
FOR THE YEAR ENDED 30 JUNE 2014

The Directors are responsible for the preparation of financial statements for each financial year that give a true and fair view of the state of affairs of the Bank as at the end of the financial year and of the Bank's surplus or deficit. The Directors also ensure that the Bank keeps proper accounting records that disclose, with reasonable accuracy, the financial position of the Bank. They are also responsible for safeguarding the assets of the Bank.

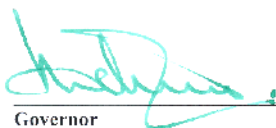
The Directors accept responsibility for the preparation and fair presentation of financial statements that are free from material misstatements whether due to fraud or error. They also accept responsibility for:

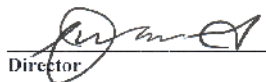
- (i) Designing, implementing and maintaining internal control necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error;
- (ii) Selecting and applying appropriate accounting policies; and
- (iii) Making accounting estimates and judgments that are reasonable in the circumstances.

The Directors are of the opinion that the financial statements give a true and fair view of the state of the financial position of the Bank at 30 June 2014 and of the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Central Bank of Kenya Act.

Nothing has come to the attention of the Directors to indicate that the Bank and its subsidiary will not remain a going concern for at least twelve months from the date of this statement.

Approved by the Board of Directors and signed on its behalf by:


Governor


Director

04/09/2014

REPUBLIC OF KENYA

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 Website: www.kenao.go.ke



P.O. Box 30084-00100
 NAIROBI

KENYA NATIONAL AUDIT OFFICE

REPORT OF THE AUDITOR-GENERAL ON CENTRAL BANK OF KENYA FOR THE YEAR ENDED 30 JUNE 2014

REPORT ON THE FINANCIAL STATEMENTS

The accompanying financial statements of Central Bank of Kenya set out on pages 11 to 47, which comprise the consolidated statement of financial position as at 30 June 2014, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory information have been audited on my behalf by PricewaterhouseCoopers, auditors appointed under Section 39 of the Public Audit Act, 2003 and in accordance with the provisions of Article 229 of the Constitution of Kenya. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

Directors' Responsibility for the Financial Statements

The Directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as Directors determine is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

The Directors are also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 13 of the Public Audit Act, 2003.

Auditor-General's Responsibility

My responsibility is to express an opinion on the financial statements based on the audit and report in accordance with the provisions of Section 15(2) of the Public Audit Act, 2003 and submit the audit report in compliance with Article 229(7) of the Constitution of Kenya. The audit was conducted in accordance with International

1

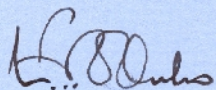
Standards on Auditing. Those standards require compliance with ethical requirements and that the audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion the financial statements present fairly, in all material respects, the financial position of the Bank as at 30 June 2014, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Central Bank Act, Cap 491 of the Laws of Kenya.



Edward R.O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

29 September 2014

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Consolidated Statement of Comprehensive Income

	Notes	Year ended 30 June 2014 Shs' million	2013 Restated Shs' million
Interest income	4	5,828	5,904
Interest expense	5	(1,069)	(4,037)
Net interest income		4,759	1,867
(Increase)/decrease in loan impairment	15	(2)	45
Net interest income after loan impairment (charge)/credit		4,757	1,912
Fees and commission income	2(q)	3,000	3,000
Net trading income	6	2,245	1,699
Other income	7	803	798
Operating income		10,805	7,409
Operating expenses	8	(12,177)	(9,404)
Operating deficit before unrealised gains/(losses)		(1,372)	(1,995)
Unrealized gains and losses:			
Foreign exchange gain		14,759	5,623
Fair value gain/(loss) on financial assets held for trading		117	(55)
Surplus for the year		13,504	3,573
Other comprehensive income			
<i>Items that will not subsequently be reclassified to profit or loss</i>			
Actuarial (loss)/gains in retirement benefit asset	17	(1,126)	2,983
Adjustment to revaluation reserve	18	(46)	-
Total comprehensive income for the year		12,332	6,556

The notes on pages 90 to 121 are an integral part of these financial statements

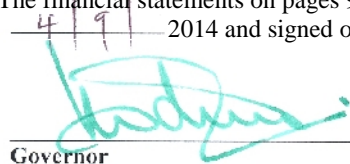
CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Consolidated Statement of Financial Position

Consolidated statement of financial position

		As at 30 June 2014	As at 30 June 2013 Restated	As at 30 June 2012 Restated
	Notes	Shs' million	Shs' million	Shs' million
Assets				
Balances due from banking institutions	10	681,397	450,693	395,283
Advances to banks	14	50	351	9,973
Funds held with International Monetary Fund (IMF)	13(a)	692	2,694	2,200
Loans and advances	15	2,654	2,645	3,560
Financial assets at fair value through profit or loss	11	78,190	77,929	42,678
Investments securities – Available-for-sale	12	6	6	-
Other assets	16	3,366	4,119	2,557
Property and equipment	18	13,813	12,052	11,651
Intangible assets	19	639	973	1,272
Retirement benefit asset	17	7,659	8,108	4,430
Due from Government of Kenya	20	66,138	35,960	38,131
Total assets		854,604	595,530	511,735
Liabilities				
Currency in circulation	21	199,966	183,047	159,216
Deposits from banks and government	22	448,800	191,671	160,642
Due to International Monetary Fund (IMF)	13(b)	130,064	118,568	101,868
Investments by banks	23	-	41,589	35,673
Other liabilities	24	5,382	2,595	1,332
Total liabilities		784,212	537,470	458,731
Equity and reserves				
Share capital	25	5,000	5,000	5,000
General reserve fund		56,539	44,161	37,605
Revaluation reserve		8,853	8,899	8,899
Proposed dividend		-	-	1,500
Total equity		70,392	58,060	53,004
Total equity and liabilities		854,604	595,530	511,735

The financial statements on pages 90 to 121 were authorised for issue by the Board of Directors on 4/9/2014 and signed on its behalf by:


Governor


Director

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Consolidated statement of changes in equity

	Notes	Share capital	General reserve fund	Revaluation reserve	Proposed dividend	Total
		Shs' million	Shs' million	Shs' million	Shs' million	Shs' million
Balance at 1 July 2012 as previously reported		5,000	35,368	8,899	1,500	50,767
Restatements on adoption of IAS 19 Revised	17	-	2,237	-	-	2,237
As restated on 1 July 2012		5,000	37,605	8,899	1,500	53,004
Surplus for the year		-	3,573	-	-	3,573
Other comprehensive income: Actuarial gains in retirement benefit asset		-	2,983	-	-	2,983
Total comprehensive income for the year		-	6,556	-	-	6,556
Transactions with owners						
Dividends paid		-	-	-	(1,500)	(1,500)
Restated balance as at 30 June 2013		5,000	44,161	8,899	-	58,060

Note:

– The revaluation reserve relates to unrealized gains on valuation of land and buildings that will not be recycled into profit or loss.

– The share capital and proposed dividend reserve have been described in note 2 (m) and 2(n) respectively.

The notes on pages 90 to 121 are an integral part of these financial statements.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Consolidated statement of changes in equity (continued)

	Notes	Share capital	General reserve fund	Revaluation reserve	Total
		Shs' million	Shs' million	Shs' million	Shs' million
Balance at 1 July 2013 as previously reported		5,000	39,020	8,899	52,919
Restatements on adoption of IAS 19 Revised	17	-	5,141	-	5,141
As restated on 1 July 2013		5,000	44,161	8,899	58,060
Surplus for the year	18	-	13,504	-	13,504
Adjustment to revaluation reserve		-		(46)	(46)
Other comprehensive income: Actuarial losses in retirement benefit asset		-	(1,126)	-	(1,126)
Total comprehensive income for the year		-	12,378	(46)	12,332
Restated balance as at 30 June 2014		5,000	56,539	8,853	70,392

Note:

– The revaluation reserve relates to unrealized gains on valuation of land and buildings that will not be recycled into profit or loss.

– The share capital and proposed dividend reserve have been described in note 2 (m) and 2(n) respectively.

The notes on pages 90 to 121 are an integral part of these financial statements.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Consolidated statement of cash flow

	Notes	Year ended 30 June	
		2014	2013
		Shs' million	Shs' million
Net cash generated from operating activities	26	219,937	67,200
Cash flows from investing activities			
Purchase of property plant and equipment	18	(2,792)	(1,230)
Purchase of intangible assets	19	(9)	(46)
Proceeds from disposal of property and equipment		30	11
Net sale/(purchase) of financial assets			
- held for trading		12,126	(32,344)
- held to maturity		(2,251)	(7,331)
- available-for-sale		-	(6)
- funds held with International Monetary Fund (IMF)		2,002	(494)
Net cash from/(used in) investing activities		9,106	(41,440)
Cash flows from financing activities			
Proceeds from International Monetary Fund (IMF)		11,496	16,700
Dividends paid		-	(1,500)
Net cash from financing activities		11,496	15,200
Increase in cash and cash equivalents		240,539	40,960
Cash and cash equivalents at start of year		408,426	367,466
Cash and cash equivalents at end of year	27	648,965	408,426

The notes on pages 90 to 121 are an integral part of these financial statements.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes

1 General information

Central Bank of Kenya (the “Bank”) is established by and derives its authority and accountability from the Central Bank of Kenya Act Cap 491 of the Laws of Kenya (the “CBK Act”). The Bank is wholly owned by the Government of Kenya and is domiciled in Kenya. The Bank acts as banker, advisor and agent of the Government of Kenya.

2 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS). The measurement basis applied is the historical cost basis, except where otherwise stated in the accounting policies below. The financial statements are presented in Kenya Shillings (Shs), rounded to the nearest million.

Changes in accounting policy and disclosures

(i) New and amended standards adopted by the Bank

IAS 19, ‘Employee benefits’ was amended in June 2011. The amendments to IAS 19 effective for periods starting on or after 1 January 2013 have been applied by the Bank for the first time. The revised standard requires that all actuarial gains and losses arising in any given year be recognised immediately in Other Comprehensive Income. Previously actuarial gains and losses outside the 10% corridor were deferred and amortised over the expected working life of employees.

The largest impact of the adoption has been an increase in the pension asset relating to unrecognized actuarial gains posted to Other Comprehensive Income as a prior year adjustment. This has led to increase in 1 July 2013 opening reserves by Shs 5,141 million. Additional disclosures have been made in the financial statements in accordance with the revised standard in note 17 to the financial statements. The retrospective effect of the standard has been incorporated on the financial statements, including the inclusion of a third column in the statement of financial position relating to the restated position at 30 June 2012, in accordance with IFRS requirements.

IFRS 13, ‘Fair value measurement’, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements, which are largely aligned between IFRSs and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. The application of IFRS 13 has resulted in enhanced fair value disclosures in the financial statements and has impacted the disclosures under note 29.

IFRS 10, ‘Consolidated financial statements’ - is a new standard that replaces the consolidation requirements in SIC-12 Consolidation—Special Purpose Entities and IAS 27 Consolidated and Separate Financial Statements. The standard builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company and provides additional guidance to assist in the determination of control where this is difficult to assess.

The revised definition of control focuses on the need to have both power and variable returns before control is present. The Bank has only one subsidiary, Kenya School of Monetary Studies, for which it has 99% ownership. The Directors are satisfied that ownership of the entity meets the revised definition of control.

There are no other IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on 1 July 2013 that would be expected to have a material impact on the Bank.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

Summary of significant accounting policies (continued)

Changes in accounting policy and disclosures (continued)

(ii) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 July 2013, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Bank, except the following:

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. Issued in November 2009 and October 2011, it replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Directors are yet to assess IFRS 9's full impact and intend to adopt IFRS 9 no later than the accounting period beginning on or after 1 January 2015.

Amendments to IAS 32 titled Offsetting Financial Assets and Financial Liabilities (issued in December 2011) – The amendments address inconsistencies in current practice when applying the offsetting criteria in IAS 32, mainly by clarifying the meaning of "currently has a legally enforceable right of set-off" and that some gross settlement systems may be considered equivalent to net settlement. They are effective for annual periods beginning on or after 1 January 2014, with retrospective application.

Amendments to IAS 36 titled Recoverable Amount Disclosures for Non-Financial Assets (issued in May 2013) – The amendments reduce the circumstances in which the recoverable amount of assets or cash-generating units is required to be disclosed, clarify the disclosures required, and introduce an explicit requirement to disclose the discount rate used in determining impairment (or reversals) where recoverable amount (based on fair value less costs of disposal) is determined using a present value technique. They are effective for annual periods beginning on or after 1 January 2014. Amendments to IAS 39 titled Novation of Derivatives and Continuation of Hedge Accounting (issued in June 2013) – The amendments permit the continuation of hedge accounting in a situation where the counterparty to a derivative designated as a hedging instrument is replaced by a new central counterparty (known as 'novation of derivatives'), as a consequence of laws or regulations, if specific conditions are met. They are effective for annual periods beginning on or after 1 January 2014.

Amendments to IFRS 10, IFRS 12 and IAS 27 titled Investment Entities (issued in October 2012) – The amendments define "investment entities" and provide them an exemption from the consolidation of subsidiaries; instead, an investment entity is required to measure the investment in each eligible subsidiary at fair value through profit or loss in accordance with IFRS 9 / IAS 39 (the exception does not apply to subsidiaries that provide services relating to the investment entity's investment activities). An investment entity is required to account for its investment in a relevant subsidiary in the same way in its consolidated and separate financial statements, and additional disclosures are introduced. The amendments are effective for annual periods beginning on or after 1 January 2014, retrospectively with some transitional provisions. The Directors do not anticipate any effect on the Bank's financial statements as the Bank is not an investment entity.

IFRIC 21 Levies (issued in May 2013) – The interpretation provides guidance on when to recognise a liability for a levy imposed by a government. The obligating event for the recognition of a liability is the activity that triggers the payment of the levy in accordance with the relevant legislation. It also provides guidance on recognition of a liability to pay levies: the liability is recognised either progressively if the obligating event occurs over a period of time, or when the minimum threshold is reached if an obligation is triggered on reaching that minimum threshold. The interpretation is effective for annual periods beginning on or after 1 January 2014

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014
Notes (continued)

2 Summary of significant accounting policies (continued)

(b) Consolidation

Kenya School of Monetary Studies is a subsidiary to the Bank. The Bank has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Bank.

The group uses the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

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The excess of the aggregate of the consideration transferred and the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss. Inter-company transactions, balances and unrealised gains on transactions between group entities are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Bank.

(c) Functional currency and translation of foreign currencies

i. Functional and presentation currency

Items included in the financial are measured using the currency of the primary economic environment in which the Bank operates (the "Functional Currency"). The financial statements are presented in Kenya Shillings ("Shs") which is the Bank's Functional Currency.

ii. Transactions and balances

Foreign currency transactions are translated into the Functional Currency using exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. All foreign exchange gains and losses are presented in profit or loss within 'foreign exchange gains/(losses)'.

(d) Sale and repurchase agreements

Securities sold subject to repurchase agreements ("repos") are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in investments by banks.

Securities purchased under agreements to resell ("reverse repos") are recorded as advances to banks. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

The Bank from time to time mops up money from the financial market ("repos") or injects money into the market ("reverse repos") with maturities of 4-7 days. The Bank engages in these transactions with commercial banks only. These have been disclosed in the financial statements as 'advances to banks' and 'investments by banks'.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities

i. Financial assets

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity and available-for-sale financial assets. The Directors determine the classification of its financial assets at initial recognition. The Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank as at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Bank designates certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed and can only be applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis or
- the financial assets consist of debt host and embedded derivatives that must be separated.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss and are reported as 'fair value loss on financial assets held for trading'. Interest income and expense and dividend income and expenses on financial assets held for trading are included in 'interest income' and 'interest expense' respectively.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest method.

The Bank operates a staff loans scheme for its employees for the provision of facilities such as house and car loans. The loans are granted to staff at an interest rate of 3% per annum which is generally below the prevailing market interest rates. Loans issued at non market rates are initially measured at fair value (by discounting the related cash flows using market rates of interest) and subsequently carried at amortised cost. The difference between the fair value of the loans and the carrying amount at inception is treated as a long term employee benefit and is accounted for as a deferred cost. The resulting loan adjustment account is released to interest income over the loan period in line with the unwinding of the discount, while the deferred cost is expensed to staff costs as the services are rendered to the Bank over the period of the loan.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

i. Financial liabilities (continued)

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period. Available-for-sale financial assets are measured at fair value. Gains or losses arising from fair value remeasurements are included in other comprehensive income.

ii. Financial liabilities

The Bank's holding in financial liabilities represents mainly deposits from banks and government and other liabilities. Such financial liabilities are initially recognised at fair value and subsequently measured at amortised cost.

Cash Reserve Ratio are statutory deposits taken from commercial banks and non-bank financial institutions for liquidity management as part of monetary policies in accordance with the Kenyan Banking Act and are interest free.

iii. Determination of fair value

For financial instruments traded in active markets, the determination of fair values of financial instruments is based on quoted market prices or dealer price quotations. This includes listed equity securities and quoted debt instruments on major exchanges and broker quotes from Bloomberg.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive. Indicators that a market is inactive are when there is a wide bid-offer spread or significant increase in the bid-offer spread or there are few recent transactions.

For all other financial instruments, fair value is determined using valuation techniques. In these techniques, fair values are estimated from observable data in respect of similar financial instruments, using models to estimate the present value of expected future cash flows or other valuation techniques, using inputs.

In cases when the fair value of unlisted equity instruments cannot be determined reliably, the instruments are carried at cost less impairment. The fair values of contingent liabilities and irrevocable loan commitments correspond to their carrying amounts.

iv. De-recognition

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

v. Classes of financial instruments

Category (as defined by IAS 39)		Class (as determined by the Bank)		2014	2013
				Shs' million	Shs' million
Financial assets	Financial assets at fair value through profit or loss	Held for trading	World Bank Reserve Asset Management Programme (RAMP) financial assets	25,989	26,263
			Fixed income securities	52,136	51,608
		Designated at initial recognition	Gold holdings	65	58
	Loans and receivables	Current, special projects and clearing accounts		264,198	55,200
		Funds held with IMF		692	2,694
		Advances to banks		50	351
		Net advances to staff and banks under liquidation		2,654	2,645
		Items in the course of collection (under 'other assets')		70	154
		Due from Government	Government loan	28,900	28,960
			Overdraft facility to Government	37,238	7,000
	Available-for-sale	Investment securities	SWIFT shares	6	6
	Held to maturity	Investment in debt securities	Term deposits	417,199	395,493
Financial liabilities	Financial liabilities at amortised cost	Deposits from banks	Term auction deposits	-	30,983
			Cash reserve ratio and current account deposits	137,289	113,647
			Repurchase agreements	-	10,606
		Deposits from Government institutions		311,511	78,024
		Due to IMF		130,064	118,568

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

2 Summary of significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

vi. Impairment of financial assets

a. Loans and receivables

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss on loans carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial instrument's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. A loan is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount, and for a collateralised loan, after taking into account any value of the security which has been realised.

b. Available for sale financial assets

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss.

If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

If any such evidence exists for available-for-sale financial assets, impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss.

vii. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(f) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014
Notes (continued)

2 Summary of significant accounting policies (continued)

(g) Property and equipment

Land and buildings comprise mainly branches and offices. All equipment used by the Bank is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Land and buildings are stated at valuation less accumulated depreciation. Valuations are carried out every three years.

Subsequent expenditures are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. The carrying amount of the replaced part is de-recognised. All other repair and maintenance costs are charged to profit or loss during the financial period in which they are incurred.

Freehold land is not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

Leasehold land	Over the period of the lease
Buildings	20 years
Motor vehicles	4 years
Furniture and equipment	5 - 10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in 'other income' in profit or loss. When revalued assets are sold, the amounts included in other reserves are transferred to the general reserve.

(h) Intangible assets

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the Bank are recognised as intangible assets when the following criteria are met:

- i. it is technically feasible to complete the software product so that it will be available for use;
- ii. management intends to complete the software product and use or sell it;
 - there is an ability to use or sell the software product;
 - it can be demonstrated how the software product will generate probable future economic benefits;
 - adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- iii. the expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalised as part of the software product include the software development employee costs and an appropriate portion of relevant overheads.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Computer software development costs recognised as assets are amortised over their estimated useful lives, which does not exceed three years.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. Software has a maximum expected useful life of 5 years.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014
Notes (continued)

2 Summary of significant accounting policies (continued)

(i) Impairment of non-financial assets

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less cost to sell or the value in use can be determined reliably. Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

(j) Employee benefits

The Bank operates a defined benefit and defined contribution pension schemes. The schemes are funded through payments to trustee-administered funds on a monthly basis.

On the defined contribution scheme, the Bank pays fixed contributions to the scheme. The payments are charged to the profit or loss in the year to which they relate. The Bank has no further payment obligation once the contributions have been paid.

The defined benefit plan defines an amount of pension benefit that an employee will receive on retirement, dependent on age, years of service and compensation.

The assets of the scheme are held by the Bank in an independent trustee administered fund. The asset recognised in the statement of financial position in respect of the defined benefit pension scheme is the fair value of the scheme's assets less the present value of the defined benefit obligation at the reporting date. The defined benefit obligation is calculated annually by an independent actuary using the projected unit method. The present value of the defined benefit obligation is determined by discounting the estimated cash outflows using interest rates of Kenya treasury bonds that have terms to maturity approximating to the terms of the related pension liability.

See note 2 (a) (i) on adoption of *IAS 19 Employee benefits (Revised)*.

The Bank and all its employees contribute to the National Social Security Fund, which is a defined contribution scheme.

A defined contribution scheme is a retirement benefit plan under which the Bank pays fixed contributions into a separate entity. The Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The Bank's contributions to the defined contribution scheme are charged to the profit or loss account in the year in which they fall due.

The estimated monetary liability for employees' accrued annual leave entitlement at the reporting date is recognised as an expense accrual.

(k) Income tax

Section 7 of the Income Tax Act exempts the Bank from any taxation imposed by law in respect of income or profits. This exemption includes stamp duty in respect of instruments executed by or on behalf of the Bank.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

2 Summary of significant accounting policies (continued)

(l) Provisions

Provisions are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation at a rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(m) Share capital

Ordinary shares are classified as 'share capital' in equity.

(n) Dividend payable

The Central Bank of Kenya Act (Cap 491) allows the Bank to retain at least 10% of realized income after taking into account expenses. In addition to this, the Board of Directors in the year 2007 set a policy that all dividends shall be net of unrealized income and other revaluations gains in addition to the retention allowed by the Act.

Dividends on ordinary shares are charged to equity in the period in which they are declared.

(o) Leases

Bank as lessee

The leases entered into by the Bank are primarily operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the profit or loss on a straight-line basis over the period of the lease.

Bank as lessor

The group leases certain property and equipment where it does not transfer substantially all the risks and benefits of ownership of the assets. The operating leases generate rental income which is recorded in the profit or loss on a straight-line basis over the period of the lease.

(p) Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised in profit or loss using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability on initial recognition. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument, and any revisions to these estimates are recognised in the income statement. The calculation includes amounts paid or received that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

2 Summary of significant accounting policies (continued)

(q) Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided.

The Bank earns from the Government a commission of 1.5% of amounts raised through its agency role in the issuance of Treasury bills and bonds. The annual commission income is limited to Shs 3 billion as per the agreement between the Bank and Treasury effective 1 July 2007. In addition, the Bank earns commissions from other debt instruments issued to meet funding requirements of State Corporations.

(r) Commitments on behalf of the Kenya Government and National Treasury

The Bank issues Treasury Bonds and Bills on behalf of the National Treasury. Commitments arising on such transactions on behalf of Kenya Government and National Treasury are not included in these financial statements as the Bank is involved in such transactions only as agent.

(s) Currency in circulation

Notes and coins in circulation are measured at cost. Currency in circulation represents the nominal value of all bank notes and coins held by the public and commercial banks.

(t) Currency printing and minting costs

The cost of unissued bank note stocks is recognised in the statement of financial position as deferred currency costs under 'other assets'.

The estimate of the useful lives of various bank notes denominations was changed in the year. The useful life of the various bank note denominations was previously estimated as follows:

Shs 1,000	2 years
Shs 500	2 years
Shs 200	2 years
All other denominations	1 year

Bank note costs are now charged to profit or loss in the year in which the bank notes are issued. The impact of the change in estimate has been the write-off of Shs 1,254 million relating to un-amortised costs of bank notes in issue at 30 June 2014.

There has been no change in accounting for coin minting costs which are charged to profit or loss when delivered and the significant risks and rewards of ownership are transferred to the Bank.

(u) Loan due from the Government of Kenya

The loan due from the Government of Kenya arose from overdrawn accounts which were converted to a loan with effect from 1 July 1997 after an amendment to the Central Bank of Kenya Act to limit the Bank's lending to Government of Kenya to 5% of Government of Kenya audited revenue.

On 24 July 2007, a deed of guarantee was signed between the Government of Kenya and Central Bank of Kenya in which the Government agreed to repay the loan at Shs 1.1 billion per annum over 32 years at 3% interest per annum. The security held is lien over cash balances, stock, treasury bonds and such other government securities as are specified in Section 46(5) of the Central Bank of Kenya Act.

The loan due from the Government of Kenya is categorised as a loan and receivables and is measured at amortised cost.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

2 Summary of significant accounting policies (continued)

(v) Funds held at/ due to International Monetary Fund (IMF)

Kenya has been a member of the International Monetary Fund (IMF) since 1966. The Bank is the designated depository for the IMF's holdings of Kenya's currency. IMF currency holdings are held in the No. 1 and No. 2 Accounts, which are deposit accounts of the IMF with the Bank.

Borrowings from and repayments to the IMF are denominated in Special Drawing Rights (SDRs). The SDR balances in IMF accounts are translated into Shillings at the prevailing exchange rates and any unrealized gains or losses are accounted for in accordance with accounting policy on foreign currencies.

On a custodial basis, the Bank holds a non-negotiable, non-interest bearing and encashable on demand security issued by the Treasury in favour of the IMF in its capacity as the IMF's depository. The security issued is in part payment of Kenya's quota of IMF shares.

(w) Comparatives

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

3 Critical accounting estimates and judgements in applying accounting policies

(a) Critical estimates in applying the entity's accounting policies

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

i. Post-retirement benefits

Post-retirement benefits are long term liabilities whose value can only be estimated using assumptions about developments over a long period. The Bank has employed actuarial advice in arriving at the figures in the financial statements (Note 18 which includes assumptions). The Board of Directors considers the assumptions used by the actuary in their calculations to be appropriate for this purpose.

ii. Loans and advances

Critical estimates are made by the management in determining the recoverable amount of impaired loans and receivables.

iii. Fair value of financial assets

The fair value of financial instruments that are not traded in an active market and off market loans are determined by using valuation techniques.

iv. Property and equipment

Land and buildings are carried at fair value; representing open market value determined periodically by internal professional valuers.

(b) Critical judgements in applying the entity's accounting policies

In the process of applying the Bank's accounting policies, management has made judgements in determining:

- the classification of financial assets and leases
- whether assets are impaired.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

4 Interest income

	Shs' million	Shs' million
Financial assets - held to maturity	1,353	1,150
Loans and advances	4,116	4,479
Financial assets - held for trading	359	275

	<u>5,828</u>	<u>5,904</u>

Interest income from loans and advances comprises:

Loan due from Government	858	892
Government overdraft	2,263	2,960
Staff loans	255	113
Reverse repos	506	368
Local commercial banks overnight loans	71	6
Foreign commercial banks overnight loans	25	29
Other interest income	138	111

	<u>4,116</u>	<u>4,479</u>

5 Interest expense

Interest on monetary policy issues – investments by banks	1,029	4,033
Interest paid to IMF	40	4

	<u>1,069</u>	<u>4,037</u>
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6 Net trading income

Net gain on sale of foreign exchange currencies	2,182	1,772
Net loss on held for trading financial assets trading	63	(73)

	<u>2,245</u>	<u>1,699</u>

7 Other income

Licence fees from commercial banks and foreign exchange bureaux	220	218
Penalties from commercial banks and foreign exchange bureaux	21	17
Rent income	2	2
Kenya School of Monetary Studies operating income - hospitality services and tuition fee	467	416
Gain on disposal of property and equipment	30	11
Miscellaneous income	63	134

	<u>803</u>	<u>798</u>

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

8 Operating expenses

	2014	2013
	Shs' million	Shs' million
Employee benefits (Note 9)	3,899	3,645
Currency production expenses	4,665	2,396
Property maintenance and utility expenses	1,129	903
Depreciation (Note 18)	985	823
Amortisation (Note 19)	343	345
Provision for impairment loss on other assets (Note 16)	21	153
Auditors' remuneration	6	6
Loss on financial assets at fair value through profit or loss	-	16
Transport and travelling	189	178
Office expenses	195	190
Postal service expense	112	136
Legal and professional fees	42	112
Other administrative expenses	591	501
	<hr/>	<hr/>
	12,177	9,404
	<hr/>	<hr/>

9 Employee benefits

Wages and salaries	3,833	3,483
Medical expenses	195	168
Other staff costs	391	447
Directors' emoluments (Note 28)	45	68
Net credit on retirement benefit obligations (defined benefit) (Note 17)	-565	-521
	<hr/>	<hr/>
	3,899	3,645
	<hr/>	<hr/>

10 Balances due from banking institutions

Foreign denominated term deposits	380,956	347,206
Accrued interest on term deposits	225	143
Current accounts	50,343	31,995
Special project accounts	199,586	13,240
Domestic foreign currency cheque clearing	14,088	9,945
Repss clearing and regional central banks	181	20
	<hr/>	<hr/>
Included in cash and cash equivalents (note 27)	645,379	402,549
	<hr/>	<hr/>
Foreign denominated term deposits	36,016	48,141
Accrued interest on term deposits	2	3
	<hr/>	<hr/>
	681,397	450,693
	<hr/>	<hr/>

All balances due from banking institutions are recoverable within one year.

Amounts included in cash and cash equivalent have a maturity of three months or less

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2014

Notes (continued)

11 Financial assets at fair value through profit or loss

	2014 Shs' million	2013 Shs' million
a. Designated at initial recognition		
Gold holdings	65	58
Movements in gold holdings are due to mark to market movements.		
b. Held for trading		
Fixed income securities	52,136	51,608
Fixed income securities under World Bank RAMP	25,989	26,263
	78,125	77,871
	78,190	77,929

12 Investments securities – Available-for-sale

Unlisted equity securities	6	6
At start of year	6	-
Additions	-	6
At end of year	6	6

The fair value of the investment in unlisted company is estimated as being equivalent to the purchase price

13 Funds held at/ due to International Monetary Fund (IMF)

	2014 SDR million	2014 Shs' million	2013 SDR million	2013 Shs' million
(a) Assets				
IMF balances (SDR asset account)	5	692	16	2,694
(b) Liabilities				
International Monetary Fund Account No. 1	19	2,661	19	2,531
International Monetary Fund Account No. 2	-	2	-	1
International Monetary Fund – PRGF Account	683	92,308	634	82,493
IMF-SDR Allocation account	260	35,093	260	33,543
	962	130,064	913	118,568

The National Treasury is the Government of Kenya's Fiscal Agent. Commitments arising on transactions between IMF, Kenya Government and National Treasury are not included in these financial statements as the Bank is not the Government's fiscal agent.

Kenya's quota in IMF of SDR 271.4 million (2013: SDR 271.4 million) and allocations of SDR 258.3 million (2013: 258.3 million) are not included in the financial statements of the Bank as these are booked in the National Treasury with the Government fiscal agent.

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
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Notes (continued)

14 Advances to banks

	2014	2013
	Shs' million	Shs' million
Treasury bonds discounted	38	333
Treasury bills discounted	11	8
Accrued interest	1	10
	<hr/>	<hr/>
	50	351
	<hr/>	<hr/>

15 Loans and advances

Due from banks under liquidation	3,656	3,656
Advances to employees	2,678	2,667
	<hr/>	<hr/>
	6,334	6,323
Allowance for impairment	(3,680)	(3,678)
	<hr/>	<hr/>
Net advances	2,654	2,645
	<hr/>	<hr/>
Movement in the loan impairment allowance is as follows:		
At start of year	3,678	3,723
Increase/ (decrease) in impairment allowance	2	-45
	<hr/>	<hr/>
At end of year	3,680	3,678
	<hr/>	<hr/>

In exceptional circumstances, as allowed by Section 36 of the Act, the Bank may act as the "lender of last resort" to financial institutions in difficulty. Commercial banks did not utilise this facility in the year under review (2013: Nil). The overnight lending attracts an interest at the CBR rate plus a margin determined by the Bank.

16 Other assets

	2014	2013
	Shs' million	Shs' million
Prepayments	688	115
Deferred currency expenses	2,250	3,477
Sundry debtors	5,218	5,212
Items in the course of collection	70	154
	<hr/>	<hr/>
	8,226	8,958
Provision for impairment	(4,860)	(4,839)
	<hr/>	<hr/>
	3,366	4,119
	<hr/>	<hr/>
All other assets balances are recoverable within one year.		
Movement in the impairment allowance is as follows:		
At start of year	4,839	4,686
Increase in impairment allowance	21	153
	<hr/>	<hr/>
At end of year	4,860	4,839
	<hr/>	<hr/>

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FINANCIAL STATEMENTS
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Notes (continued)

17 Retirement benefit asset

	2014	2013	2012
	Shs' million	Restated Shs' million	Restated Shs' million
Present value of funded obligations	17,006	13,065	12,673
Fair value of plan assets	-24,665	-21,173	-17,103
	<hr/>	<hr/>	<hr/>
Asset in the statement of financial position	-7,659	-8,108	-4,430
	<hr/>	<hr/>	<hr/>

Movements in the net defined benefit asset are as follows:

At start of year	8,108	4,430	1,897
Net income/(expense) recognised in profit or loss	565	521	-45
Actuarial (loss)/gain recognized in other comprehensive income	-1,126	2,983	2,213
Employer contributions	112	174	365
	<hr/>	<hr/>	<hr/>
At end of year	7,659	8,108	4,430
	<hr/>	<hr/>	<hr/>

Movements in the plan assets are as follows:

At start of year	21,173	17,103	15,872
Return on scheme assets	2,858	2,358	1,492
Actuarial gain	1,192	2,087	565
Employer contributions (Note 9)	112	174	365
Employee contributions	55	60	-
Benefits expenses paid	-667	-428	-467
Adjustment for previous year values	-58	-181	-724
	<hr/>	<hr/>	<hr/>
At end of year	24,665	21,173	17,103
	<hr/>	<hr/>	<hr/>

Movements in the plan benefit obligation are as follows:

At start of year	13,065	12,673	12,137
Current service cost net of employees' contributions	457	311	565
Interest cost	1,779	1,707	1,072
Employee contributions	55	60	-
Actuarial loss/(gain)	2,318	-1,258	-1,259
Past service cost	-	-	625
Benefits paid	-668	-428	-467
	<hr/>	<hr/>	<hr/>
At end of year	17,006	13,065	12,673
	<hr/>	<hr/>	<hr/>

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2013

Notes (continued)

17 Retirement benefit asset (continued)

	2014	2013	2012
	Shs' million	Restated Shs' million	Restated Shs' million
The amounts recognised in profit or loss are as follows:			
Current service costs	457	311	565
Interest costs	1,779	1,707	1,071
Return on plan assets	(2,858)	(2,358)	(1,492)
Past service costs	-	-	625
Adjustments for previous year's values	57	(181)	(724)
	<hr/>	<hr/>	<hr/>
Total (credit)/expenses included in employee benefits	(565)	(521)	45
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

The principal actuarial assumptions at the reporting date were:

Discount rate (p.a.)	12.90%	13.70%	12.50%
Salary increase (p.a.)	10.90%	11.70%	10.50%
Expected return on plan assets (p.a.)	12.90%	13.70%	12.50%
Future pension increases	3.00%	3.00%	3.00%

Plan assets are distributed as follows:

	2014	2013	2012
Quoted shares	40%	39%	32%
Investment in properties	11%	13%	16%
Government of Kenya Treasury bills and bonds	30%	27%	43%
Commercial paper and corporate bonds	6%	6%	7%
Offshore investments	9%	8%	-
Fixed and term deposits	3%	7%	3%
	<hr/>	<hr/>	<hr/>
	100%	100%	100%
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

	2013	2012
	Shs' million	Shs' million
Retirement benefit asset		
As previously stated	2,967	2,193
Prior year adjustment	5,141	2,237
	<hr/>	<hr/>
Restated asset	8,108	4,430
	<hr/> <hr/>	<hr/> <hr/>

CENTRAL BANK OF KENYA
FINANCIAL STATEMENTS
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Notes (continued)

	Freehold land and Buildings Shs' million	Leasehold land and buildings Shs' million	Work in progress Shs' million	Motor Vehicles Shs' million	Furniture and Equipment Shs' million	Total Shs' million
Year ended 30 June 2013						
Cost or valuation						
At start of year	6,042	1,805	1,194	310	5,638	14,989
Additions	-	-	819	63	348	1,230
Disposals	-	-	-	(21)	(2)	(23)
At end of the year	<u>6,042</u>	<u>1,805</u>	<u>2,013</u>	<u>352</u>	<u>5,984</u>	<u>16,196</u>
Accumulated depreciation						
At start of year	19	6	-	180	3,133	3,338
Adjustments	-	-	-	2	4	6
Charge for the year	303	33	-	50	437	823
On disposal	-	-	-	(21)	(2)	(23)
At end of the year	<u>322</u>	<u>39</u>	<u>-</u>	<u>211</u>	<u>3,572</u>	<u>4,144</u>
Net carrying value	<u>5,720</u>	<u>1,766</u>	<u>2,013</u>	<u>141</u>	<u>2,412</u>	<u>12,052</u>
Year ended 30 June 2014						
Cost or valuation						
At start of year	6,042	1,805	2,013	352	5,984	16,196
Adjustment to revaluation reserve	(46)	-	-	-	-	(46)
Additions	-	-	2,373	71	348	2,792
Disposals	-	-	-	(35)	(4)	(39)
At end of year	<u>5,996</u>	<u>1,805</u>	<u>4,386</u>	<u>388</u>	<u>6,328</u>	<u>18,903</u>
Accumulated depreciation						
At start of year	322	39	-	211	3,572	4,144
Charge for the year	304	35	-	66	580	985
On disposal	-	-	-	(35)	(4)	(39)
At end of the year	<u>626</u>	<u>74</u>	<u>-</u>	<u>242</u>	<u>4,148</u>	<u>5,090</u>
Net carrying value	<u>5,370</u>	<u>1,731</u>	<u>4,386</u>	<u>146</u>	<u>2,180</u>	<u>13,813</u>

Land and buildings were revalued by internal professional valuers in 2012 on an open market basis and the revaluation has been included in the revaluation reserve. The next valuation is due in 2015 in accordance with the Bank's policy.

Land and buildings are included in the level 2 fair valuation hierarchy (that is, the fair value is based on inputs other than quoted prices that are observable).

The methods and significant assumptions applied in arriving at the revalued amounts are as follows:

- The Bank's residential properties are all owner-occupied. In carrying out the valuation, the Bank has assumed that the prospective rental income to be generated by the property based on the going rentals for similar properties within the same location.
- The Bank has taken into account comparables values of similar properties (plot, construction standards, design, (lay out), size, location, – current sale prices of vacant plots and those developed) to derive the market prices. These were obtained from market transactions of comparable properties.

Included in land and buildings is land in Kisumu and Mombasa, valued at Shs 486 million, for which the Bank is in the final stage of registration of titles. All the necessary documentation to facilitate titles preparation has been completed and the Leases are awaiting signature. The Bank is in possession and occupies all the properties. The Directors expect this process to be completed in the next 12 months from the date of these financial statements.

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Notes (continued)

19 Intangible assets

	Software Shs' million	Work-in-Progress Shs' million	Total Shs' million
Year ended 30 June 2013			
Cost			
At start of year	1,572	-	1,572
Additions	46	-	46
At end of year	1,618	-	1,618
Accumulated amortisation			
At start of year	300	-	300
Amortisation for the year	345	-	345
At end of year	645	-	645
Net carrying value	973	-	973
Year ended 30 June 2014			
Cost			
At start of year	1,618	-	1,618
Additions	-	9	9
At end of year	1,618	9	1,627
Accumulated amortisation			
At start of year	645	-	645
Amortisation for year	343	-	343
At end of year	988	-	988
Net carrying value	630	9	639

20 Due from Government of Kenya

	2014 Shs' million	2013 Shs' million
Overdraft	37,238	7,000
Loan	28,900	28,960
	66,138	35,960

Section 46(3) of the Central Bank of Kenya Act sets the limit of the Government of Kenya's overdraft facility at the Bank at 5% of the Gross Recurrent Revenue as reported in the latest Government of Kenya audited financial statements. The limit stands at Shs 39,123 million (2013: Shs 34,187 million) based on the Government financial statements for 2013/2012 (2013: 2012/2011), which are the latest audited financial statements at the date of approval of these financial statements.

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Notes (continued)

21 Currency in circulation

	2014	2013
	Shs' million	Shs' million
Kenya bank notes	193,640	177,488
Kenya coins	6,326	5,553
Commemorative coins	-	6
	<hr/>	<hr/>
	199,966	183,047
	<hr/>	<hr/>

Movement in the account was:

At start of year	183,047	159,216
Deposits by banks	(458,585)	(403,689)
Withdrawals by banks	475,504	427,520
	<hr/>	<hr/>

At end of year	199,966	183,047
	<hr/>	<hr/>

22 Deposits from banks and government

Local commercial banks clearing accounts and cash ratio reserve	123,766	104,366
Local banks foreign exchange settlement accounts	13,476	9,248
External banks foreign exchange settlement accounts	47	33
Other public entities and project accounts	207,836	19,954
Government of Kenya	103,675	58,070
	<hr/>	<hr/>
	448,800	191,671
	<hr/>	<hr/>

23 Investment by banks

Term auction deposits	-	30,983
Repos sold to commercial banks	-	10,606
	<hr/>	<hr/>
	-	41,589
	<hr/>	<hr/>

24 Other liabilities

Impersonal accounts	1,654	248
Sundry creditors	1,559	926
Bonds pending payables	1,331	620
Refundable deposits	682	677
Leave accrual	118	76
Gratuity to staff members	38	48
	<hr/>	<hr/>
	5,382	2,595
	<hr/>	<hr/>

CENTRAL BANK OF KENYA
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Notes (continued)

25 Share capital	Authorised share capital Shs' million	Ordinary shares Shs' Million
Balance at 1 July 2012, 30 June 2013 and 30 June 2014	5,000	5,000

Ownership of the entire share capital is vested in the Cabinet Secretary to the National Treasury.

26 Cash generated from operations	2014 Shs' million	2013 Shs' million
Reconciliation of net surplus to cash flows from operations		
Surplus for the year	13,504	3,573
Adjustments for:		
Depreciation (Note 18)	985	823
Amortisation (Note 19)	343	345
Gain on disposal of property and equipment	(30)	(11)
Net credit on defined benefit asset (Note 9)	(565)	(521)
Employer contributions on the defined benefit asset (Note 17)	(112)	-
Changes in working capital:		
Loans and advances	(9)	915
Other assets	753	(1,562)
Due from Government of Kenya	(30,178)	2,171
Currency in circulation	16,919	23,831
Deposits	257,129	31,029
Other liabilities	2,787	691
Investments by banks	(41,589)	5,916
	219,937	67,200

CENTRAL BANK OF KENYA
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Notes (continued)

27 Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include:

	2014	2013
	Shs' million	Shs' million
Balances due from banking institutions	645,379	402,549
Financial assets - held for trading	3,536	5,526
Advances to banks (Note 14)	50	351
	<hr/>	<hr/>
	648,965	408,426
	<hr/>	<hr/>

28 Related party transactions

In the course of its operations, the Bank enters into transactions with related parties, which include the Government of Kenya, the ultimate owner of the Bank, and the Deposit Protection Fund Board (a corporation established by law as a deposit insurance scheme to provide cover for depositors and act as a liquidator of failed member institutions. It is managed by a Board comprising the Governor of the Central Bank of Kenya as the Chairman).

The main transactions include ordinary banking facilities to government ministries included in Note 22 and lending to Government of Kenya included in Note 20.

(i) Loans

The Bank extends loan facilities to the Governor and the Deputy Governor and other key management personnel. The advances are at preferential rates of interest determined by the Bank.

	2014	2013
	Shs' million	Shs' million
Loans to executive Directors		
At start of year	13	6
Loans advanced during the year	-	11
Loan repayments	(5)	(4)
	<hr/>	<hr/>
At end of year	8	13
	<hr/>	<hr/>
Loans to key management personnel		
At start of year	77	87
Loans advanced during the year	17	20
Loan repayments	(23)	(30)
	<hr/>	<hr/>
At end of year	71	77
	<hr/>	<hr/>

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FINANCIAL STATEMENTS
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Notes (continued)

28 Related party transactions (continued)

	2014	2013
	Shs' million	Shs' million
(ii) Directors' emoluments:		
Fees to non-executive Directors	15	15
Other remuneration to Executive Director/(s)	30	53
	<hr/>	<hr/>
	45	68
	<hr/>	<hr/>
(iii) Remuneration to senior management	196	172
	<hr/>	<hr/>
(iv) Post-employment pension to senior management	10	11
	<hr/>	<hr/>
(v) Government of Kenya		
Due from Government of Kenya (Note 20)	66,138	35,960
	<hr/>	<hr/>
i. Banking services;		
ii. Management of issue and redemption of securities at a commission; and		
iii. Foreign currency denominated debt settlement and other remittances at a fee.		

(vi) Deposit Protection Fund Board

The Bank has a close working relationship with the Deposit Protection Fund Board, an entity incorporated under the Banking Act, and provides it with staff and office accommodation. Certain costs incurred on behalf of the Deposit Protection Fund Board are fully reimbursed to the Bank.

The balance outstanding from the Deposit Protection Fund Board and included in other assets as at year end was Shs 18.9 million (2013: Shs 20 million).

(vii) Kenya School of Monetary Studies

The Kenya School of Monetary Studies is a registered legal entity wholly owned by the Bank and has been consolidated in these financial statements.

29 Financial risk management objectives and policies

The Bank's activities expose it to a variety of financial risks, including credit risk and the effects of changes in debt and equity market prices, foreign currency exchange rates and interest rates. The Bank's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance.

Risk management is carried out by the Financial Markets Department under policies approved by the Board of Directors. Other organs that monitor the assessment and management of risks within the Bank include: Board Audit Committee, Internal Audit Department and Risk Management Unit.

CENTRAL BANK OF KENYA
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Notes (continued)

29 Financial risk management objectives and policies (continued)

(a) Strategy in using financial instruments

The Bank holds foreign exchange reserves for the purposes of servicing official foreign debt, paying non-government debt and Central Bank of Kenya expenditures abroad, and occasional intervention in the foreign exchange market to smoothen exchange rate volatilities. The Bank can only intervene in the foreign exchange market when there are sharp exchange rate movements which are likely to destabilize the financial market.

Governed by the Bank's reserve management policy of safe investment, liquidity and return, respectively, the Bank, with a prudent approach, subjects its foreign exchange reserves to investments in international markets.

In this framework, almost all the financial risks to which the Bank is exposed arise while fulfilling its duties of managing foreign exchange reserves and rendering certain banking services to the banking sector and the Government of the Republic of Kenya.

The Bank is exposed to credit, market and liquidity risks due to the aforementioned operations. The financial risks that arise during the management of foreign exchange reserves are the outcome of an investment choice. Nevertheless, the Bank endeavours to minimize such risks by managing them with a conservative approach.

Foreign exchange reserves are managed by observing the investment criteria defined in the Bank's Guidelines on Foreign Exchange Reserves Management.

(b) Risks facing the Bank

The following are the main types of risks that the Bank is exposed to in the course of executing its operations:

• Financial risks include:

- Credit risk
- Market risk:
 - Interest risk
 - Foreign currency exchange risk
- Liquidity risk

• Non-financial risks include:

- Operational risk
- Human resource risk
- Legal risk
- Reputation risk

i. Credit risk

Credit risk arises from investment securities, balances due from banking institutions, funds held with IMF, loans and advances as well as other assets. The Bank has no significant concentrations of credit risk except for the lending to the Government of Kenya.

Management of the credit risk is through the choice of depository banks. The Bank's choice of depository banks is confined to top international banks that meet the set eligibility criteria of financial soundness on long-term credit rating (A), short-term credit rating (AA), composite rating and capital adequacy.

The amount that best represents the Group's maximum exposure to credit risk is per the statement of financial position.

The Bank does not grade the credit quality of these assets. None of the balances have had their terms renegotiated. Management monitors the credit exposure of staff on a continuous basis, taking into account their financial position, past experience and other factors. Provisions of Shs 104 million (2013: Shs 83 million) have been recorded due to impaired balances to related parties.

CENTRAL BANK OF KENYA
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Notes (continued)

29 Financial risk management objectives and policies (continued)

i. Credit risk (continued)

The following amounts in loans and advances and other assets are neither past due nor impaired or individually impaired. All other financial instruments operate within their contractual terms.

	Neither past due nor impaired	Individually impaired	Neither past due nor impaired	Individually impaired
	2014	2014	2013	2013
	Shs' million	Shs' million	Shs' million	Shs' million
Advances to employees	2,654	24	2,646	22
Due from banks under liquidation (Note 15)	-	3,656	-	3,656
Sundry debtors	3,366	4,860	4,004	4,839
	6,020	8,540	6,650	8,517
Allowance for impairment				
- other assets (Note 16)	-	(4,860)	-	(4,839)
- loans and advances (Note 15)	-	(3,680)	-	(3,678)
	-	(8,540)	-	(8,517)
	6,020	-	6,650	-

ii. Market risk

The Bank takes on exposure to market risks, which is the risk that fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates and equity prices. The Bank separates exposures to market risk into either trading or non-trading portfolios.

Market risks arising from trading and non-trading activities are concentrated in Bank Treasury and are monitored by management through guidelines from the Foreign Reserves Investments Committee (FRIC) with oversight from the Financial Stability Committee.

Trading portfolios include those positions arising from market-making transactions where the Bank acts as principal with commercial banks or the market.

Non-trading portfolios primarily arise from the interest rate management of the Bank's investments and monetary policy assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the Bank's held-to-maturity and World Bank RAMP financial assets.

Interest rate risk

The Bank's interest rate risk arises from interest bearing investments, loans and advances to commercial banks and investments by banks. Borrowings issued at variable rates expose the Bank to cash flow interest rate risk which is partially offset by cash held at variable rates. Borrowings issued at fixed rates expose the Bank to fair value interest rate risk.

The tables below summarise the Bank's financial assets and liabilities and analyses them into the earlier of contractual maturity or repricing.

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29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

As at 30 June 2014	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Non-interest Bearing Shs' million	Total Shs' million
Assets						
Balances due from banking institutions	381,181	29,680	-	-	270,536	681,397
Advances to banks	50	-	-	-	-	50
Financial assets at fair value through profit or loss	3,536	48,596	-	25,961	97	78,190
Funds held with International Monetary Fund (IMF)	-	-	-	-	692	692
Investments securities – Available-for-sale	-	-	-	-	6	6
Loans and advances	22	87	653	1,892	-	2,654
Other assets	-	-	-	-	448	448
Due from Government of Kenya	-	38,348	4,440	23,350	-	66,138
Total financial assets	384,789	116,711	5,093	51,203	271,779	829,575
Liabilities						
Deposits from banks and government	-	-	-	-	448,800	448,800
Due to International Monetary Fund (IMF)	-	-	-	-	130,064	130,064
Other liabilities	-	-	-	-	5,382	5,382
Total financial liabilities	-	-	-	-	584,246	584,246
Interest sensitivity gap	384,789	116,711	5,093	51,203	(312,467)	245,329



29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Interest rate risk (continued)

As at 30 June 2013

	1 – 3 months Shs' million	3-12 months Shs' million	1 - 5 years Shs' million	Over 5 years Shs' million	Non-interest Bearing Shs' million	Total Shs' million
Assets						
Balances due from banking institutions	347,349	42,471	-	-	60,873	450,693
Advances to banks	351	-	-	-	-	351
Financial assets at fair value through profit or loss	5,526	12,602	33,581	25,623	597	77,929
Funds held with International Monetary Fund (IMF)	-	-	-	-	2,694	2,694
Investments securities – Available-for-sale	-	-	-	-	6	6
Loans and advances	2	37	824	1,782	-	2,645
Other assets	-	-	-	-	527	527
Due from Government of Kenya	-	8,110	4,440	23,410	-	35,960
Total financial assets	353,228	63,220	38,845	50,815	64,697	570,805
Liabilities						
Deposits from banks and government	-	-	-	-	191,671	191,671
Due to International Monetary Fund (IMF)	-	-	-	-	118,568	118,568
Investments by banks	41,589	-	-	-	-	41,589
Other liabilities	-	-	-	-	2,595	2,595
Total financial liabilities	41,589	-	-	-	312,834	354,423
Interest sensitivity gap	311,639	63,220	38,845	50,815	(248,137)	216,382

As at 30 June 2014, an increase/decrease of 10 basis points would have resulted in a decrease/increase in surplus of Shs 762 million (2013: Shs 700 million).



29 Financial risk management objectives and policies (continued)

ii. Market risk

Foreign currency exchange risk

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Foreign Reserves Investments Committee (FRIC) sets limits on the level of exposure by currency which is monitored daily.

The table below summarises the Bank's exposure to foreign currency exchange rate risk as at 30 June 2014. Included in the table are the Bank's financial instruments categorised by currency:

As at 30 June 2014

Assets

Balances due from banking institutions

Financial assets at fair value through profit or loss

Funds held with International Monetary Fund (IMF)

Total financial assets

Liabilities

Due to International Monetary Fund (IMF)

Deposits from banks and government

Total financial liabilities

Net position

	USD Shs' million	GBP Shs' million	EUR Shs' million	SDR Shs' million	Others Shs' million	Total Shs' million
Balances due from banking institutions	476,823	99,833	53,589	-	51,152	681,397
Financial assets at fair value through profit or loss	78,190	-	-	-	-	78,190
Funds held with International Monetary Fund (IMF)	-	-	-	692	-	692
Total financial assets	555,013	99,833	53,589	692	51,152	760,279
Liabilities						
Due to International Monetary Fund (IMF)	-	-	-	130,064	-	130,064
Deposits from banks and government	207,337	1,207	1,576	-	160	210,280
Total financial liabilities	207,337	1,207	1,576	130,064	160	340,344
Net position	347,676	98,626	52,013	(129,372)	50,992	419,935



29 Financial risk management objectives and policies (continued)

ii. Market risk (continued)

Foreign currency exchange risk (continued)

As at 30 June 2013

Assets

	USD Shs' million	GBP Shs' million	EUR Shs' million	SDR Shs' million	Others Shs' million	Total Shs' million
Balances due from banking institutions	310,089	83,280	33,693	-	23,631	450,693
Financial assets at fair value through profit or loss	77,929	-	-	-	-	77,929
Funds held with International Monetary Fund (IMF)	-	-	-	2,694	-	2,694
Total financial assets	388,018	83,280	33,693	2,694	23,631	531,316

Liabilities

Due to International Monetary Fund (IMF)	-	-	-	118,568	-	118,568
Deposits from banks and government	8,195	1,161	1,189	-	-	10,545
Total financial liabilities	8,195	1,161	1,189	118,568	-	129,113
Net position	379,823	82,119	32,504	-115,874	23,631	402,203

As at 30 June 2014, if the shilling had weakened/strengthened by 5% against the major currencies with all other variables held constant, the impact on the Bank's surplus would have been:

- USD Shs 27,328 million (2013: Shs 18,991 million)
- Euro Shs 2,601 million (2013: Shs 1,625 million)
- British Pound Shs 4,931 million (2013: Shs 4,106 million)
- SDR Shs 6,469 million (2013: Shs 5,794 million)



29 Financial risk management objectives and policies (continued)

iii. Liquidity risk

Prudent liquidity risk management includes maintaining sufficient cash and marketable securities, and the availability of funding from an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, Treasury maintains flexibility in funding by maintaining availability under committed credit lines.

Management monitors rolling forecasts of the Bank's liquidity reserve on the basis of expected cash flow.

The table below analyses the Bank's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the statement of financial position date to the contractual maturity date. The amounts disclosed in the table below are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

	On demand Shs' million	1 – 3 months Shs' million	3–12 months Shs' million	1 – 5 years Shs' million	Over 5 years Shs' million	Total Shs' million
As at 30 June 2014						
Currency in circulation	-	-	-	-	199,966	199,966
Deposits from banks and government	437,587	11,213	-	-	-	448,800
Due to International Monetary Fund (IMF)	-	-	-	-	130,064	130,064
Other liabilities	-	-	5,382	-	-	5,382
Total financial liabilities	437,587	11,213	5,382	-	330,030	784,212
As at 30 June 2013						
Currency in circulation	-	-	-	-	183,047	183,047
Deposits from banks and government	178,259	-	13,412	-	-	191,671
Due to International Monetary Fund (IMF)	-	-	-	-	118,568	118,568
Investments by banks	-	41,589	-	-	-	41,589
Other liabilities	-	-	2,595	-	-	2,595
Total financial liabilities	178,259	41,589	16,007	-	301,615	537,470

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Notes (continued)

29 Financial risk management objectives and policies (continued)

Fair value of financial instruments

IFRS 7 specifies a fair value hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, Bloomberg).
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg.
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

	Level 1 Shs' million	Level 2 Shs' million	Level 3 Shs' million	Total Shs' million
As at 30 June 2014:				
Financial assets at fair value	78,125	65	-	78,190
Investment securities – Available-for-sale	-	-	6	6
Total assets	78,125	65	6	78,196
As at 30 June 2013:				
Financial assets at fair value	77,871	58	-	77,929
Investment securities – Available-for-sale	-	-	6	6
Total assets	77,871	58	6	77,935

Changes in level 3 instrument are disclosed in Note 12 to the financial statements.

30 Contingent liabilities and commitments

The Bank is party to various legal proceedings. Based on legal advice, the Directors believe that no loss will arise from these legal proceedings. Appropriate provisions have been made where a liability is considered probable.

At 30 June 2014, the Bank did not have capital commitments (2013: Nil) in respect of property and equipment purchases.

Operating lease commitments – Bank as lessee

	2014 Shs'	2013 Shs'
Not later than 1 year	-	16
Later than 1 year and not later than 5 years	40	40
	40	56

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